Exhibit A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

In the Matter of	)	
	)	
Petition of Verizon for Forbearance	)	
From The Prohibition of Sharing	)	**CC Docket No. 96-149**
Operating, Installation, and	)	
Maintenance Functions Under Section	)	
53.203(a)(2) Of The Commission's Rules	)	

AT&T's OPPOSITION TO VERIZON PETITION FOR FORBEARANCE

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AT&T's OPPOSITION TO VERIZON PETITION FOR FORBEARANCE

Pursuant to the Commission's Notice,[1] AT&T Corp. ("AT&T") hereby submits its opposition to the Petition of Verizon for Forbearance ("Petition") from the prohibition on sharing of operating, installation, and maintenance services.[2]

INTRODUCTION AND SUMMARY

In the *Non-Accounting Safeguards Order*, the Commission concluded "that allowing the same personnel to perform the operation, installation, and maintenance services associated with a BOC's network and the facilities that a section 272 affiliate owns or leases from a provider other than the BOC would create the opportunity for such substantial integration of operating functions as to preclude independent operation, in violation of section 272(b)(1)." *Non-Accounting Safeguards Order* ¶ 163. Relying on a principle established in 1983 when the BOCs were first created, the Commission stressed that section 272(b)(1)'s "operate independently" requirement

[1] Public Notice, Wireline Competition Bureau Seeks Comment On Verizon's Petition For Forbearance From The Prohibition Of Sharing Operating, Installation And Maintenance Functions, CC Docket 96-149 (released Aug. 9, 2002).

[2] *See* 47 C.F.R. § 53.203(a); *Non-Accounting Safeguards Order*, 11 FCC Rcd. 21905, ¶¶ 158-70 (1996); *see also BOC Separations Order*, 95 F.C.C. 2d 1117, 1144 (¶ 70) (1983).

barred such sharing of operation, installation, and maintenance ("OI&M") services, in part because such shared service arrangements "would inevitably afford access to the BOC's facilities that is superior to that grant to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation." *Id.* (citing *BOC Separations Order*). The OI&M prohibition is a vital tool to fulfill section 272's central purpose of "prohibit[ing] anticompetitive discrimination and cost-shifting." *Id.* ¶ 9; *see* 47 U.S.C. § 272(b) (establishing the "operate independently," "arm's length" dealing, and other accounting safeguards on the section 272 affiliate); *id.* § 272(c) (imposing broad and unqualified prohibitions against discrimination by the BOC).

The BOC's strongly objected to the Commission's OI&M safeguard and sought reconsideration. The Commission rejected these reconsideration requests, reaffirming that section 272 precludes shared OI&M services, and recognizing that any other ruling would "create a loophole around the separate affiliate requirement" and would provide for such "substantial integration of these essential functions . . . that independent operation would be precluded." *Non-Accounting Safeguards Third Order On Reconsideration*, ¶ 20.[3]

Verizon's forbearance petition rehashes the same arguments that the Commission has repeatedly rejected. Verizon points to no changed circumstances that could provide any reasonable basis for the Commission to change course and decide that the OI&M services restriction is no longer required by Section 272 and no longer is necessary to protect competition, consumers, and the public interest. The underlying basis for the OI&M rule, and for the operate independently and nondiscrimination requirements – the BOC's market power in the local exchange market and its ability and incentive to leverage this market power to undermine

[3] *Non Accounting Safeguards Third Order on Reconsideration*, 17 Comm. Reg (P&F) 920 (rel. Oct. 1, 1999).

competition in the long distance market – is as strong now as it was when the Commission first announced the rule.

Verizon claims that the Commission's concerns of improper cost allocation are misplaced, and that the OI&M services restriction results in a loss in efficiency and fewer new services. But these are the precise arguments previously presented by the BOCs and rejected by the Commission. *See*, *e.g.*, *Non-Accounting Safeguards Order*, ¶¶ 153, 163 (rejecting BOCs' claim that OI&M restriction is inappropriate because it will "result in a loss of efficiency and economies of scale, decrease innovation, and fewer new services").

Verizon now suggests that it has "new" information concerning the costs of the OI&M restriction, which the Commission did not have when it first announced the rule. But the conclusory claims of its costs of compliance with the OI&M services restriction are unsupported and unaccompanied by any documentation that could allow them to be independently verified. These assertions also are belied by Verizon's rapid growth in the market, and simply ignore the enormous competitive benefits in avoiding otherwise "inevitable" market power abuses.

In fact, if there was any error in the Commission's original balancing of costs and benefits in this area, it is that is that the Commission *underestimated* the competitive harm arising from shared BOC/272 affiliate services, and allowed *too much* sharing and too many opportunities for anticompetitive cost misallocations and discrimination. Verizon and other BOCs have clearly exploited these opportunities. Indeed, recent 272 audits have revealed pervasive violations of the sharing and other 272 rules that do exist. State commissions and competing carriers have likewise compiled a substantial record in the section 272 sunset proceeding showing that BOCs retain market power, even in states where they have long been offering long distance service – including in several non-BOC territories where section 271 authorization was not even required. As a result, there is still a substantial risk of discrimination and cost misallocation by the BOCs – the very conduct that the Commission has for years determined the OI&M prohibition is absolutely necessary to prevent. Indeed, the record in that section 272 sunset proceeding is rife with anticompetitive behavior and other BOC violations of section 272 safeguards. Given the substantial threat that BOCs can leverage local market power to re-monopolize the long distance market, the OI&M ban should be retained.

Verizon's claim that other accounting and non-accounting safeguards will adequately protect against anticompetitive conduct should the OI&M ban be lifted has been rejected by the Commission – in 1999 (*Non-Accounting Safeguards Third Order On Reconsideration*), in 1997 (*Non-Accounting Safeguards Second Order On Reconsideration*),[4] in 1996 (*Non-Accounting Safeguards Order*), and 1983 (*BOC Separations Order*). Moreover, Verizon's reliance on other section 272 restrictions to support OI&M forbearance is at best misleading, given Verizon's contention in the ongoing section 272 sunset proceedings that these restrictions should sunset at the end of this year.

Nor can there be any serious claim that the OI&M safeguard seriously handicaps the BOCs. Verizon, for example, claims that its 272 affiliate, with only 800 employees, has quickly gained up to 34.2% market share, more than other facilities-based and better-staffed competitors gained in many years. *See* Selwyn Section 272 Sunset Reply Dec. ¶ 6 (and cited materials).[5] The costs of the prohibition against joint OI&M remain critically necessary and clearly impose

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[4] *Non-Accounting Safeguards Second Order On Reconsideration*, 12 FCC Rcd. 8653, ¶¶ 11-12 (1997).

[5] *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, Reply Declaration of Dr. Lee Selwyn ("Selwyn Section 272 Sunset Reply Dec.") (filed Aug. 26, 2002). A copy of the Selwyn Section 272 Sunset Reply Dec. is attached hereto as Exhibit A.

no serious or unwarranted restriction on Verizon, given that it has already become one of the largest long distance carriers in the nation with the OI&M safeguards in place. The Petition should be denied.

I. VERIZON'S PETITION SEEKS TO PROVIDE VERIZON WITH UNIQUE ADVANTAGES OVER ITS NON-BOC COMPETITORS.

Verizon's Petition claims that forbearance is necessary to overcome "marketing handicaps" and other disadvantages allegedly caused by the prohibition on OI&M sharing. Petition at 6. In fact, precisely the opposite is true: if Verizon and its 272 affiliates are permitted to share OI&M functions, they will be uniquely positioned and will gain advantages available to no non-BOC carrier that will enable them to meet customers' demands for "service reliability and meeting deadlines." *See* McCully Dec. ¶ 3.

For example, under the current market conditions, if a customer seeks to subscribe to a bundle of services (*e.g.,* McCully Dec. ¶ 5), the carrier (whether a BOC affiliate or some other company) must order local facilities from the BOC in order to provide the services. With the OI&M services restriction, the BOC affiliate and unaffiliated carriers must go through the same processes to obtain repair services for the facilities used to provide such services. They both must call the BOC, schedule installation and maintenance, and pay tariffed rates – precisely the "handoffs of customer requests" (McCully Dec ¶¶ 4, 6) which Verizon claims are burdensome. Without the OI&M prohibition, however, the 272 affiliate would have unique advantages over its non-BOC competitors, because competitors would still confront the very same burdensome processes about which Verizon so vociferously complains. No longer forced to use the same installation and repair procedures that unaffiliated carriers now use, the 272 affiliate would be able to steer the customer directly to the BOC personnel responsible for performing OI&M functions.

Verizon asserts that the "OI&M restriction puts Verizon at a significant disadvantage in competing with carriers that are able to offer an integrated service platform using their own local and long distance facilities." Petition at 7. But Verizon can make such a claim only because it ignores the substantial market power that it and other BOCs retain over exchange access, even in markets where they have obtained section 271 authority. Because of that local market power, rival carriers of the BOCs are generally *not* able to offer integrated service platforms using their own local and long distance facilities because, in the vast majority of instances, rival carriers do not own local facilities. Accordingly, when Verizon complains that it and its section 272 affiliate "cannot respond as a single team that can maintain end-to-end service," Petition at 7, it is describing *precisely* what a competing carrier must do to offer such services. Because the BOCs' market power endures long after section 271 authorization, rival carriers (just like the BOC section 272 affiliate) generally must rely on the BOC for access to last mile access facilities. The prohibition against joint OI&M, therefore, is absolutely necessary to prevent the BOC section 272 affiliate from gaining an unfair advantage over rival carriers – and, consistent with Congress' purposes, to "ensure that BOCs compete on a level playing field." *Texas 271 Order* ¶ 395.[6]

As Dr. Selwyn discussed more fully in the Section 272 sunset proceeding, the "disadvantage" of which Verizon complains exists only in the rare circumstances that the BOC's competitors actually own their own local service or other "last mile" network assets. Selwyn Section 272 Sunset Reply Dec. ¶ 16. When, however, as is overwhelmingly the case, a competing IXC or CLEC is dependent on the BOC for such facilities, then it is in exactly the

[6] *Texas 271 Order,* 15 FCC Rcd. 18354 (2000) (citation omitted).

same position as a BOC's section 272 affiliate in providing "end-to-end service" to a customer. *Id.*

Thus, contrary to Verizon's claim (at 1-2) that the OI&M ban inhibits the section 272 affiliate from offering services in the same way as unaffiliated competitors, precisely the opposite is true – which is why the Commission adopted its rule in the first place, and why it cannot rationally abandon it now, before the BOCs' market power has fully dissipated and all carriers are on truly equal footing. *See Non-Accounting Safeguards Order* ¶ 9.

II. THE COMMISSION'S LIMITED BAN ON SHARING OF OI&M SERVICES SHOULD CONTINUE TO APPLY TO ALL BOCS

As the Commission has repeatedly found for years, the OI&M prohibition is also critical in preventing discrimination and cost misallocation. *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12; *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20. Verizon claims that forbearance is justified because the Commission allows the BOCs and their 272 affiliates to share other services (like legal and human resources departments), and that the Commission's safeguards aimed at preventing cost misallocation of those shared services can be applied in the same fashion to shared OI&M services. Petition at 4. But even if that were true – and it is not, as described below – Verizon's Petition completely ignores the "inevitabl[e]" risks of discrimination that apply with much greater force to core network operations like OI&M services. *See Non-Accounting Safeguards Order* ¶ 163 ("allowing a BOC to contract with the section 272 affiliate for [OI&M] services would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors") (emphasis added). As the Commission has found, BOCs retain significant ability and incentive to discriminate – particularly with the new services for which, Verizon claims (at 5), the OI&M prohibition is "anachronistic." The outright ban on OI&M is necessary to attempt to prevent the numerous and often subtle forms of discrimination that can occur if such services can be freely shared.

A. The OI&M Prohibition Is The Only Effective Way To Inhibit Discrimination.

Verizon claims that the Commission unfairly singled out and banned joint OI&M services, while it permitted BOCs to share other functions, such as "finance, human resources, legal and accounting." Verizon at 4. However, the Commission was well within its authority to ban joint OI&M, because, as the Commission found, such OI&M services would "inevitably" afford the affiliate with discriminatory access to the BOC's facilities, and "substantial integration" of such "essential functions" would preclude independent operation. *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20. Verizon's Petition provides no basis for protecting against this discrimination if the OI&M prohibition is lifted.

There is ample reason to believe that BOCs retain the ability to discriminate against rivals, particularly when performing such core network functions as OI&M. Indeed, the Commission recently concluded that since 1996 the BOCs have an *increased* incentive and ability to discriminate against rivals as a result of their mergers. In approving mergers of the largest dominant LECs, the Commission found that the remaining large incumbent LECs "not only will have *more* incentive to discriminate against rivals, but also will have a *heightened* ability to inhibit competitors' provision of services."[7] *SBC-Ameritech Merger Order* ¶ 194 (emphasis added); *Bell Atlantic-GTE Merger Order* ¶¶ 173-78.[8] The Commission also stressed

[7] While the BOCs proposed conditions that were alleged to offset these harms, the BOCs have often failed meaningfully to fulfill (or have affirmatively violated) those conditions.

[8] *SBC/Ameritech Merger Order,* 14 FCC Rcd. 14712 (1999); *Bell Atlantic-GTE Merger Order*, 15 FCC Rcd. 14032 (2000).

in these recent orders that structural safeguards were required, rather than relying on rules of nondiscrimination, because BOCs can engage in a myriad subtle forms of discrimination, and it is "impossible for the Commission to foresee every possible type of discrimination." *SBC-Ameritech Merger Order* ¶ 206.

Moreover, the Commission found that the risks of discrimination were the greatest for new and advanced services, because there was little or no track record by which to gauge the BOC's performance. As the Commission explained, "With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination." *SBC-Ameritech Merger Order* ¶ 220.

For that reason, Verizon's claims (at 5 & Diefenderfer Dec.) that the OI&M prohibition "imposes inefficiencies that raise the costs of introducing broadband service" is irrelevant, even if it were true. Because the risks of discrimination against rivals for such services is much greater, the prohibition on joint OI&M services is all the more important for broadband and other new and advanced services.

B. The OI&M Prohibition Also Reduces The Difficulties In Determining If The BOC Is Misallocating Costs

Although preventing discrimination is a goal more than sufficient to justify the OI&M rule, the rule also serves a vital role in preventing cost misallocation. Verizon claims that the Commission's existing accounting and other safeguards are adequate to prevent such allocations, and that the Commission has found those rules to be sufficient to protect against cost misallocation for other shared services like joint legal or human resources departments. Verizon at 4 (claiming there is "no fundamental difference between the cost allocations necessary to monitor sharing of OI&M" and other shared services). The Commission's previous orders necessarily rejected these very same contentions, however, and Verizon provides no basis for the Commission to overturn its prior judgment. *See Non-Accounting Safeguards Order*, ¶¶ 163, 167; *Non-Accounting Safeguards Third Order On Reconsideration*, ¶¶ 15, 20.

In addition, given the significant violations of section 272 that have occurred and that AT&T and other parties have catalogued, there is no basis to rely on Verizon's claims that the Commission's existing accounting safeguards are sufficient to detect, deter, and remedy cost misallocations related to the sharing of "ancillary" services like legal or human resources departments. *See* Section 272 Sunset Proceeding, AT&T Reply Comments, at 7.[9] For example, as AT&T explained its section 272 sunset comments, a recent ALJ decision in California found "clear[] . . . cross-subsidization" in Pacific Bell's provision of marketing information and customer databases to the 272 affiliate. Section 272 Sunset Proceeding, AT&T Comments, at 37-39.[10]

Even apart from these problems, however, the prohibition on OI&M functions serves a valuable and unique role in preventing cost misallocation. As the Commission concluded in 1996, "allowing the same individuals to perform such *core functions* on the facilities of both entities would create *substantial opportunities* for improper cost allocation." *Non-Accounting Safeguards Order* ¶ 163 (emphases added). The Commission has recognized since at least 1983 that "sharing of such services would require 'excessive, costly, and burdensome regulatory

[9] Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No. 02-112, Reply Comments of AT&T Corp. ("Section 272 Sunset Proceedings, AT&T Reply Comments").

[10] In all events, AT&T has explained that some BOCs have manipulated those safeguards so that they no longer disclose any information regarding interaffiliate transactions. Section 272 Sunset Proceeding, AT&T Comments, at 40.

involvement in the operations, plans, and day-to-day activities of the carrier [in order] to audit and monitor the accounting plans necessary for such sharing to take place.'" *Id.* (quoting *BOC Separations Order*, 95 F.C.C.2d 1144, ¶ 70). Rather than attempt to engage in such oversight, the Commission properly determined to ban joint OI&M altogether. *See also Non-Accounting Safeguards Third Order On Reconsideration*, ¶ 20 (recognizing "the burdensome regulatory involvement that would be necessary to detect and deter such cost misallocation").

The operation, installation and maintenance of networks and network facilities represents the heart of a telecommunications company – and for the BOC, relates directly to the source of the BOCs' bottleneck control over local exchange and exchange access facilities. As the Commission has recognized, permitting joint OI&M gives rise to myriad joint and common costs that could easily and undetectably be misallocated. Contrary to the BOCs' claims, attempting to separate those costs between a BOC and its affiliate is difficult – and the consequences of error more severe – than attempting to separate the costs of ancillary services like an accounting or human resources department.

The sheer difference in magnitude of core OI&M activities relative to corporate overhead service functions such as legal and human resources also must not be overlooked. Even a small (percentage) misallocation in the case of OI&M could result in an orders-of-magnitude greater dollar cost shift than a large (percentage) misallocation of corporate overhead services. Moreover, allocation of overhead service functions can be accomplished through relatively straightforward and readily auditable processes: For example, human resources department costs can be allocated between the BOC and the 272 affiliate in proportion to the number of employees on each entities' payroll; legal services can be allocated on the basis of hours worked for each entity, as reflected on timesheets, in much the same manner as a private law firm would "allocate" its costs to its individual clients.

Core OI&M activities – and in particular the "joint" OI&M activities that would benefit both the BOC and the affiliate – present far more complex cost allocation challenges. For example, the same team of plant personnel might be dispatched to jointly perform a low-priority repair for the BOC entity and a high-priority function in the same vicinity for the affiliate. Strategic scheduling of work functions, coupled with creative cost allocation techniques, could result in a systematic shifting of costs away from the affiliate and over to the BOC, effectively producing precisely the type of cross-subsidy about which the Commission has on numerous occasions expressed concern. *See Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12 (discussing unique opportunities for cost misallocation arising from shared facilities and OI&M services).

Even if the Commission could be confident that it could allocate the time spent by legal or accounting personnel on tasks for the 272 affiliate rather than the BOC, the appropriate allocation of joint and common costs (*i.e.*, the cost of the repair truck) incurred as a result of OI&M would be much more difficult. The Commission thus was correct when it determined that regulatory oversight in this area would be expensive, time consuming, and largely ineffective, and thus that the only meaningful method of inhibiting cost misallocation is through structural safeguards like the ban on shared OI&M services.

III. VERIZON VASTLY EXAGGERATES THE COSTS OF COMPLIANCE WITH THE OI&M BAN

Verizon claims that the OI&M prohibition creates "operational inefficiencies" on the BOCs, and is the "major factor in the additional costs caused by the section 272 separation rules." Verizon at 3. Verizon, focusing primarily on the costs of "hiring additional personnel" and "separate OSS," asserts that compliance with the OI&M services restriction will cost it a total of $495 million for the period from 1998 through 2006. Howard Dec. ¶ 5.

However, the declarations that Verizon submits are little more than conclusory statements that opine generally about costs, without any backup material that could be used to verify these claims. *See* Howard Dec. ¶¶ 4-5. Accordingly, these declarations should be given no weight. At the very least, Verizon must produce the back-up materials used to derive the cost figures reached before such figures could be considered.

Moreover, these Verizon declarations are on their face incomplete, because they contain no estimates for the costs of integrating their OI&M services, which would offset savings Verizon alleges would arise from such integration. As Dr. Selwyn has pointed out in the Section 272 Sunset proceeding, the BOCs have in other contexts commented that the costs of integration can be substantial. Selwyn Section 272 Sunset Reply Dec. ¶ 28. For example, Verizon's August 12, 2002 10-Q filing with the SEC identifies approximately $2 billion in costs through 2002 for "integrating systems," and "relocating employees," among other integration costs, arising from the GTE-Bell Atlantic merger that formed Verizon. Yet here Verizon provides no information on the inevitable costs of integrating the OI&M services function, making Verizon's calculations even more suspect and incomplete.

In addition, when evaluated in the context of the regulatory balancing that led to the OI&M services restriction, the costs of compliance with the OI&M ban are unlikely to be significant. The Commission's *Non-Accounting Safeguards Order* allowed BOCs and their affiliates to share numerous services and take advantages of efficiencies and economies of scale arising from such shared services. *Non-Accounting Safeguards Order* ¶ 168. Although these joint activities present significant risks of anticompetitive behavior, and could also easily have been prohibited entirely as inconsistent with the requirement that BOCs and their section 272 affiliates "operate independently," the Commission permitted such activities, which substantially reduced the BOCs' costs of compliance with section 272. *See*, *e.g.*, WorldCom 272 Sunset Proceeding Comments at 7-9; TWTC 272 Sunset Proceeding Comments at 17-20. In fact, it is obvious that the integration that the Commission has allowed provides significant benefits to the BOCs' section 272 affiliates – surely no other company but a BOC affiliate could only recently begin offering long distance services and capture significant market share by using just 800 employees, as Verizon has done. *See* WorldCom 272 Sunset Proceeding Comments at 8; *see also* Selwyn Section 272 Sunset Reply Dec. ¶¶ 6-8. These facts belie any notion that OI&M compliance costs are so significant that they impede Verizon's ability to compete effectively. Indeed, those costs have not deterred the BOCs from submitting many additional applications to provide long distance services through these allegedly costly separate affiliates. That is because the BOCs know the costs are insignificant compared to the benefits they can obtain by leveraging the power over bottleneck facilities into the long distance market.[11]

IV. THE FORBEARANCE STANDARD HAS NOT BEEN MET.

As Verizon acknowledges, the Commission cannot decide to forbear from applying the OI&M services restriction without finding that such forbearance meets each of the standards set

[11] Verizon has well-publicized its successes in the long distance market. For example, Verizon has reported that, as of the end of 2001, only two years after it began offering long distance service in New York, its long distance affiliate Verizon Long Distance had captured approximately 2.3-million residential customers in New York. Verizon Press Release, "Verizon Communications Reports Solid Results for Fourth Quarter, Provides Outlook for 2002," January 31, 2002. Similarly, Verizon reported a long distance market share of 17.9% in Massachusetts just ten months after receiving section 271 authority. Verizon Press Release, "Verizon Communications Reports Solid 3Q Earnings and Provides Outlook for Remainder of 2001," October 30, 2001. Verizon also recently reported that its long distance customer base has grown by some 800,000 customers in the second quarter of 2002 alone. Jane Black, "The Bells' Big Local Headache," *BusinessWeek Online*, August 21, 2002.

forth in Section 10 of the Act. *See* 47 U.S.C. § 160. Thus, the Commission may forbear from applying the OI&M services restriction only if it finds, among other things, that enforcement is "not necessary for the protection of consumers," "is consistent with the public interest," and will promote "competitive market conditions." *Id.* § 160 (a) & (b). None of these findings can be made here.

As an initial matter, in first imposing the OI&M services restriction, the Commission found that it was needed to promote full and fair competition, further the public interest, and protect consumers (and competition) from anticompetitive BOC conduct. *See Non-Accounting Safeguards Order*, ¶¶ 163, 167; *Non-Accounting Safeguards Second Order On Reconsideration*, ¶¶ 12, 53; *Non-Accounting Safeguards Third Order On Reconsideration* ¶¶ 15, 20. The Commission found that anticompetitive discrimination would be an inevitable consequence of lifting the ban on shared OI&M services. *Non-Accounting Safeguards Order*, ¶ 163. Similarly, the Commission determined that this ban was needed to avoid "improper cost allocation that Section 272 was designed to prevent." *Non-Accounting Safeguards Second Order On Reconsideration*, ¶ 12. Verizon's Petition presents no reasonable basis or cognizable evidence to justify the Commission changing its prior considered judgment.

In addition, as discussed above, the facts and market conditions compel this conclusion even if the Commission had not already ruled on these matters. As the Commission has long recognized, while the BOCs continue to have market power they will have both the incentive and ability to use their control over bottleneck local facilities to discriminate against competitors in long distance (and other) retail markets in order to favor their own competing retail operations. *SBC-Ameritech Merger Order* ¶¶ 12, 190. Requiring that the BOC and its Section 272 affiliate "operate independently," as required by section 272(b)(1), is fundamental to the Act's protections against anticompetitive discrimination and improper cost allocation. *See supra* pp. 7-12.

Under these circumstances, the OI&M restriction continues to be needed to protect competition, and hence consumers, from anticompetitive BOC conduct. Its elimination will impede, not accelerate, the development of competition in the local exchange market. And its elimination creates a substantial risk that the BOC will be able to improperly leverage its local market power to undermine existing competition in the long distance market.[12]

[12] Verizon's Petition fails to show how any benefits from the elimination of the OI&M restriction would offset these costs to consumers and competition. Even if its alleged cost savings were correct (which cannot be assumed because Verizon has provided no details other than unsupported, conclusory allegations), Verizon makes no case as to why these savings to Verizon and its section 272 affiliate will benefit consumers in the already-competitive long distance market, and does not even suggest that it would create benefits for consumers in the local exchange market. Verizon suggestion (at 5) that these cost savings would allow it to expand offerings in the small broadband market, besides being speculative and unverifiable, cannot outweigh the inevitable damage to competition and consumers in the local exchange and interLATA market.

CONCLUSION

For the foregoing reasons, the Commission should deny Verizon's Petition to forbear enforcement of the bar on shared OI&M services.

Respectfully submitted,

/s/ Aryeh S. Friedman

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Counsel for AT&T Corp.

September 9, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of September, 2002, I caused true and correct copies of the forgoing Opposition of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: September 9, 2002
Washington, D.C.

/s/ Peter M. Andros
Peter M. Andros

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	**WC Docket No. 02-112**

Reply Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

August 26, 2002

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REPLY DECLARATION OF LEE L. SELWYN

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements

WC Docket No. 02-112

REPLY DECLARATION OF LEE L. SELWYN

Introduction

Lee L. Selwyn, of lawful age, declares and says as follows:

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I submitted a Declaration on behalf of AT&T Corp. on August 5, 2002 in the above-captioned proceeding.

2. In their Comments and accompanying Declarations submitted in this proceeding, the Bell Operating Companies ("BOCs") and their advocacy organization, the United States Telecom Association ("USTA"), contend, generally, that in establishing the three-year "sunset" provision at Section 272(f)(1) of the *Telecommunications Act of 1996* (the "Act") and despite having specifically given the FCC the authority to "extend[] such 3-year period

by rule or order," Congress had actually *intended* that the Section 272 separate affiliate requirement and associated inter-affiliate transaction restrictions and requirement *would expire* at the end of three years barring some "compelling" condition or extraordinary event.[1] Qwest and BellSouth reject the suggestion that the Commission's consideration as to the merits of such an extension should include, among other things, the extent to which a BOC continues to possess and to exercise market power in the local exchange market or the potential harm that BOCs, with the separate affiliate requirement eliminated while maintaining overwhelming local market dominance, may inflict upon competition in the adjacent long distance market.[2] Verizon refers to its losses of local service market share, which have been minimal at best, as somehow providing evidence that their market power has been eroded.[3] They insist that a requirement that they continue to operate their in-region interLATA long distance businesses out of structurally separate affiliates will engender costs and operating inefficiencies that place the BOCs at a competitive disadvantage relative to rival interexchange carriers and that will exceed any benefits that such separation would produce.[4] SBC, Verizon and BellSouth argue that the *Computer III* regime, which eliminated structural

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1. BellSouth Comments, at 3, 6, 9; Verizon Comments, at 6.

2. Qwest Comments, at 4; BellSouth Comments, at 15.

3. Verizon Comments, at 6.

4. *Id.*, at 9 and Howard Affidavit; SBC Comments, at 7-8; BellSouth Comments, at 19; Qwest Comments, at 13-14.

separation for BOC customer premises equipment ("CPE") and enhanced services, should apply with equal force in the case of long distance.[5]

3. The purpose of this Reply Declaration is to respond to these various factual claims and to demonstrate that, in addition to being exaggerated and in many instances altogether false, none of the positions being advanced by the BOCs provide a sufficient basis for eliminating or sunsetting the Section 272 separate affiliate requirement at this time.

- First, nothing in the language of the 1996 *Act* or its legislative history limits the scope of the FCC's rulemaking relating to extending the three-year sunset of the Section 272 separate affiliate requirement, nor imposes upon the FCC a requirement that the sunset be extended only upon a finding that a "compelling" or "extraordinary" condition requires such action.

- Second, since the separate affiliate requirement was included in the 1996 *Act* specifically to limit the BOCs' ability, as dominant incumbent local exchange carriers with extensive market power, to discriminate against or otherwise engage in anticompetitive conduct vis-a-vis rival carriers, Section 272 should remain in full force and effect as long as the BOCs continue to possess such market power.

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5. Bellsouth Comments, at 5-9; Verizon Comments, at 3-6; SBC Comments, at 19-23.

- Third, despite the relatively small reductions in BOC market shares that have occurred over the past six-plus years, the BOCs remain dominant local exchange carriers within their traditional service footprints, and retain extensive and pervasive market power. The BOCs are no less able today to engage in discriminatory and anticompetitive conduct with respect to rival carriers than they were as of the date of enactment.

- With the separate affiliate requirement in place, the BOCs' Section 272 long distance affiliates confront exactly the same conditions with respect to access to the BOCs' networks as do nonaffiliated interexchange carriers. Contrary to the BOCs' claims, there is no need for the affiliates to construct duplicate network facilities, since access to the BOCs' facilities can be obtained by the affiliate at tariff rates. In contrast, elimination of the Section 272 separate affiliate requirement would afford the (then integrated) BOC long distance business units with enormously superior access to BOC network facilities, re-creating precisely the conditions that led to the 1984 break-up of the former Bell System and undermining competitive activity to the point where remonopolization of the nation's long distance market would become a serious concern.

There has been no diminution in the BOCs' ability to engage in anticompetitive conduct merely as a result of the passage of time, and for that reason the sunset date for the Section 272 separate affiliate requirement should be extended.

Because the BOCs retain extensive market power and market dominance with respect to local exchange and carrier access services, extension of the Section 272 separate affiliate requirements is required in order to protect competition in the long distance market.

4. BellSouth repeatedly advances the "basic premise" that "absent compelling circumstances,"[6] "compelling need[s]"[7] or "compelling reason[s],"[8] Congress contemplated that "a BOC should be relieved of its Section 272 obligations three years after receiving authority to provide in-region, interLATA telecommunications services ..."[9] BellSouth does not offer or cite to any authority in the *Act*, to its legislative history, or to any FCC rulings as support for this contrived "compelling circumstances" standard, nor could it, since no such authority or language is anywhere to be found. With respect to the three-year time frame and the sunset provision, all that the statute says is that the separate affiliate requirement sunsets "unless the Commission extends such three year period by rule or order."[10] Nothing in the *Act* or in its legislative history provides any standards or guidelines that the FCC is to follow in considering whether in fact it should "extend[] such three year period by rule or order." The *Act* simply does not say or imply what BellSouth says it says, *viz.*, that "absent *compelling circumstances*, a BOC should be relieved of its Section 272 obligations three years after receiving authority to provide in-region, interLATA telecommunications services." Indeed,

6. BellSouth Comments, at 9.

7. *Id.*, at 3.

8. *Id.*, at 6.

9. *Id.*, at 3, 6, and 9.

10. 47 C.F.R 272(f)(1).

had Congress intended to limit the scope of the FCC's authority with respect to extending the 272 sunset, it would have included any such restrictions directly in Section 272. In fact, the *Conference Report* indicates that Congress intended a broad scope for the Commission's 272 sunset rulemaking proceeding. When adopting the three year "sunset provisions," the Conference Committee noted that "[i]n any case, the Commission is given authority to extend the separate affiliate requirement by rule or order."[11]

5. Even if the Commission were to accept BellSouth's self-created "premise" that the Commission can only extend the separate affiliate requirements given "compelling reasons," such "compelling reasons" clearly exist. Although both BellSouth and Qwest argue that the facts of local market share are irrelevant to the question of Section 272,[12] this claim ignores the obvious impact of local market power upon competition in the long distance market. Congress enacted Section 272 "in order to check potential market power abuses."[13] In light of this Congressional goal, the contentions of Qwest and BellSouth that market power is irrelevant to this proceeding is absurd. Evidence of market power and market power abuses indicate that the separate affiliate provisions of Section 272, far from being sunset, should be strengthened "by rule or order." If the purpose of enacting Section 272 was "in order to check potential market power abuses," then it is both necessary and entirely appropriate for the Commission, in this proceeding, to determine whether the BOCs still possess market

11. 142 Cong. Rcc. H1118 (January 31, 1996).

12. Qwest Comments, at 5, BellSouth Comments, at 16.

13. 142 Cong. Rcc. H1171 (February 1, 1996).

power and, if they do, that one fact alone provides sufficient basis and justification for extending the sunset date. The presence of pervasive market power and market dominance by the BOCs in the residential and small business local services affords BOCs with:

- The unique ability to leverage that local market power so as to diminish competition in and, ultimately, to remonopolize the adjacent residential/small business long distance market;

- The ability and the incentives to discriminate against competing local and long distance carriers with respect to the provision of essential services; and

- The ability and the incentives to price those essential services and their own retail services in such a way as to create a price squeeze the practical effect of which will be to make effective competition in the retail service market all but impossible.

Evidence of anticompetitive conduct and of the dangers to competition in the interLATA market arising directly as a result of the BOCs' continuing market power is *by itself* fully sufficient to provide the "compelling circumstances" or "compelling reasons" that BellSouth's self-created "standard" for extending the 272 sunset would require.

6. The extraordinarily adverse impact of BOC local market power upon the interLATA market can be readily observed. In those states in which in-region long distance authority has

been granted, the extraordinary rate at which the BOC 272 affiliates have been able to acquire customers and market share is a direct result of the BOCs' market power and the exercise thereof with respect to long distance service. Preemptive use of the "inbound channel" by both Verizon and SBC to "sell" their long distance service to new *local service customers* lies at the core of these two companies' marketing strategy, and in fact has been the principal explanation for their extraordinary success in acquiring customers in the first two years in which they were permitted into the long distance business. Verizon reported that as of the end of 2001, only two years after it began offering long distance service in New York, its long distance affiliate Verizon Long Distance had captured some 2.3-million residential customers in New York,[14] representing a market share of approximately 34.2% of the residential subscribers in Verizon New York's service areas. SBC reported that through the first quarter of 2001, *less than nine months* following its Section 271 entry in Texas, the Company had signed up 21% of its 10-million Texas access lines for SBC long distance.[15] Elsewhere, ten months after receiving 271 authority in Massachusetts, Verizon reported a long distance market share of 17.9%.[16] And Verizon has just announced that in the second quarter of 2002 alone, its long distance customer base has grown by some 800,000.[17]

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14. Verizon Press Release, "Verizon Communications Reports Solid Results for Fourth Quarter, Provides Outlook for 2002," January 31, 2002.

15. *SBC Investor Briefing*, April 23, 2001, at 7.

16. Verizon Press Release, "Verizon Communications Reports Solid 3Q Earnings and Provides Outlook for Remainder of 2001," October 30, 2001.

17. Jane Black, "The Bells' Big Local Headache," *BusinessWeek Online*, August 21, 2002.

7. But for the BOCs' ability to exploit their inbound *local* marketing channel *for the benefit of their long distance affiliate*, there is no *a priori* reason to expect their rate of market share growth to differ materially from that of the OCCs[18] in the initial years following "equal access." Conversely, evidence of substantially greater BOC long distance market share growth serves to confirm the enormous value that BOCs and their interLATA affiliates obtain solely by virtue of their status as dominant local exchange carriers. Without access to the BOCs' legacy customer base, the BOC interLATA affiliates could be expected to gain market share at levels similar to those that had been experienced by the OCCs following the introduction of equal access. By 1989, roughly five years following the completion of BOC equal access upgrades, all of the OCCs combined accounted for only 22.7% of presubscribed lines.[19] Verizon New York was able to surpass that figure in slightly over one year, while it appears that SBC in Texas achieved that same market share in less than one year. And as for the 34.2% share that Verizon achieved after just 24 months following its entry into the New York long distance market, *no single OCC has ever achieved that high a share, even after more than fifteen years following the establishment of "equal access."*

18. The term "Other Common Carriers" ("OCCs") was used in the period immediately following the 1984 break-up of the former Bell System to refer to interexchange carriers other than AT&T.

19. Federal Communications Commission, Wireline Competition Bureau, Industry Analysis Division, *Long Distance Market Shares, Fourth Quarter 1998*, March, 1999, Table 2.2.

8. The BOCs' unique ability to engage in joint marketing and to benefit uniquely from their legacy relationships with the vast majority of residential and small business local service customers in their effort at acquiring long distance market share has the potential to lead ultimately to BOC remonopolization of the long distance market, at least at the retail residential and small business level. That potential would be exacerbated if the separate affiliate requirement were to be eliminated, because the BOCs would then be in a position to complement their already substantial joint marketing advantage with the additional ability and opportunity to discriminate against competitors in the provision of access and other essential services and the creation of price squeezes between the BOCs' own retail long distance prices and those being charged to rivals for access to the BOCs' networks. Remonopolization will ultimately lead to higher retail long distance prices, potentially costing consumers billions of dollars nationwide. And we won't have to wait for full remonopolization before those rate increases will be initiated. As I noted in my August 5 Declaration at para. 47, "SBC was sufficiently satisfied with its early market performance in Texas that after only seven months the company *increased* its interstate long distance rates by over 10%." Whatever the "costs" of separate affiliates may be — and as I shall discuss below the unsupported figures being advanced by the BOCs here are almost certainly gross exaggerations — the potential harms to competition and consumers arising from BOC remonopolization of retail long distance services more than justify those "costs" on a strictly cost/benefit basis.

9. Qwest itself has recognized and acknowledged this linkage between the existence of BOC local market power and anticompetitive harm to the adjacent long distance market.

Qwest states that the extension of the sunset is unnecessary because the remaining non-structural safeguards will suffice to ensure competition.[20] Qwest notes, however that "[o]f course, once the BOCs cease to have market power, such reporting requirements [of section 272(e)] would no longer be necessary and should be eliminated."[21] Qwest therefore concedes both that it retains local market power *and* that the presence of that market power should have an impact upon the continued application of Section 272 on the BOCs.

10. BellSouth advances the claim, again without citing any support or authority for its position, that

> Congress never intended Section 272 to serve as a market review statute. The relevant criteria for BOC interLATA relief is the opening of the local exchange market to competition. Section 271 with its 14-point checklist is the relevant provision for that analysis, not Section 272.[22]

BellSouth then *leaps* to its unsupported and unsupportable theory that inasmuch as there is no market share or market power test required for Section 271 *entry* authority,[23] there must also be no such market share or market power test with respect to the Section 272 separate affiliate sunset:

20. Qwest Comments, at 7.

21. *Id.*, at 8, fn. 20.

22. BellSouth Comments, at 15.

23. *Id.*, at 16.

> Given that there is no statutory basis for converting Section 272 into a market analysis statute, the Commission should not — and, in fact, cannot — link the sunset of the Section 272 separate affiliate requirements to the state of local competition in particular markets. That analysis would have already occurred when the Commission granted a BOC authority to offer in-region, interLATA telecommunications services.[24]

Of course, "that analysis" would decidedly *not* "have already occurred when the Commission granted a BOC authority to offer in-region, interLATA telecommunications services" because such an analysis is expressly precluded so long as the 14-point checklist has been satisfied.[25] BellSouth's incredibly circular theory turns the statute on its head: Section 271 does not contain a market power test; hence, as I noted in my August 5 Declaration,[26] there is no basis upon which the Commission can infer from the fact that a BOC has satisfied the 14-point checklist that it no longer has market power. If Congress had believed that a BOC's mere satisfaction of the checklist was by itself sufficient to constrain the BOC's market power, then there would have been no purpose in enacting Section 272 or in giving the FCC the opportunity and authority to extend the sunset date. BellSouth's convoluted reading of Sections 271 and 272 serves only to eviscerate Congress' purpose for including Section 272 in the *Act* by substituting the mere *passage of time* for *actual marketplace facts* as the sole basis for the sunset, BellSouth's analysis is clearly meritless and must be rejected.

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24. *Id.*

25. See, e.g. *Joint Application by BellSouth Corporation, BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, CC Docket No. 02-35, *Memorandum Opinion and Order*, FCC 02-147, at para. 14.

26. Selwyn Declaration, August 5, 2002, at paras. 10-11.

11. Unlike BellSouth and Qwest, Verizon and SBC do seem to accept the validity of an inquiry into a BOC's local market share as probative as to the existence of such a "compelling justification," but of course each then contends that there is now sufficient competition to justify the sunset. Verizon argues that "... competition has flourished. The number of lines served by incumbent local exchange carriers has declined for the last three years running, a trend that has never occurred before in over a century of telephone service."[27] What Verizon does not bother to mention is that a portion of that decline is the result of factors other than competition from CLECs. For example, the *Washington Post* reported last year that:

> A top executive at Verizon Communications Inc. said yesterday that the number of its telephone lines connected to homes and businesses has declined for the first time in the company's history, as consumers cut back on spending or shift to wireless phones and high-speed Internet connections
>
> Ivan Seidenberg, president and co-chief executive of the nation's largest phone company, said the falloff accelerated in the past two months as businesses in particular began to rethink expansion or relocation plans.[28]

A *Wall Street Journal* report reached a similar conclusion — that customers are discontinuing second residential lines and replacing them with wireless phones and high-speed internet

27. Verizon Comments, at 6.

28. "Verizon Records First Drop in Phone Lines; Firm Still Pursuing Voice Services, but Sees Internet as Future, President Says," Yuki Noguchi, *The Washington Post*, September 11, 2001, at E-1.

connections, and specifically that "second lines ... account for most of the recent line loss."[29] The replacement of a second residential access line with a wireless phone and/or a high-speed Internet connection does not signal the kind of "competitive loss" that would indicate a consequential diminution of a BOC's market power with respect to local wireline services. 42% of wireless phones in the US are served by carriers owned or controlled by BOCs.[30] BOCs also serve a substantial share of the residential high-speed Internet access market, so in those cases where customers are discontinuing their second dial-tone line to be replaced by a DSL channel, the BOC will likely experience an *increase* in revenue, certainly not a loss. There is no indication that there has been any decline in the number of *primary* residential access lines — actual *customers* — being served by BOCs. Verizon cites the number of CLEC lines in the FCC's *Local Competition Report*, especially competitive lines in states where the BOCs have been granted section 271 authority, and cites wireless phone substitution as proof of continued developments in competition.[31] SBC states that "... market evidence demonstrates that competition in the local and exchange access markets increases materially after Section

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29. "More Callers Cut Off Second Phone Lines for Cellphones, Cable Modems," Shawn Young, *The Wall Street Journal*, November 15, 2001, at B1.

30. *Seventh Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, FCC 02-179, Released July 3, 2002, at Table 4.

31. On that particular point, CMRS carriers are subject to lower average access charges on "long distance" calls than are wireline carriers, because they do not pay access charges on calls between the wireless phone (based upon the rating point of its phone number) and any other location within the same Major Trading Area ("MTA"). Hence, the out-of-pocket costs that wireless carriers incur in providing "free" long distance calling are considerably lower than the comparable costs incurred by wireline carriers, particularly by CLECs.

271 authority is granted. The Commission has confirmed that 'states with long distance approval show greatest competitive activity.''"[32]

12. That BOCs, with their overwhelming presence and huge customer penetration within their respective geographic footprints, have market power with respect to local and access services is underscored by the Commission's April 2001 *CLEC Access Charge Order*,[33] in which the Commission concluded that even small CLECs still possess market power with respect to the provision of access to *their own* end-user customers:

> Sprint and AT&T both persuasively characterize both the terminating and the originating access markets as consisting of a series of bottleneck monopolies over access to each individual end user.[34]

On that basis, the Commission established rate caps and other rules respecting such services.[35] If a small CLEC — whose share of the local market is in the low single-digit range or less — has market power with respect to "last mile" access, then it is nothing short of preposterous to suggest that BOCs do not.

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32. SBC Comments, at 16.

33. *In the Matter of Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, *Seventh Report and Order and Further Notice of Proposed Rulemaking*, FCC 01-146, Adopted April 26, 2001, Released April 27, 2001 ("*CLEC Access Charge Order*").

34. *Id.*, at para. 30.

35. *Id.*, at para. 34 *et seq.*

13. In my August 5, 2002 Declaration, I noted that there were in fact a number of states with long distance entry authorization in which there is very little local competition.[36] And, as the FCC has determined with respect to CLECs, the mere fact that the BOC may now have less than a 100% share of the local market does not mean that it no longer has market power. In any event, even if BOCs may be experiencing a slight drop in their share of the retail local service market as they claim, that does not materially change — or diminish — their market power, particularly with respect to essential services and facilities being provided to competing carriers, IXCs and CLECs. And when one compares the small local market share losses being claimed by the BOCs with the massive long distance market share losses being suffered by IXCs in those states in which the BOC has achieved in-region entry, it should be patently clear that the BOC's control and dominance of the local market is not being effectively challenged by such local service competition as may exist at the present time.

The Section 272 separate affiliate today has exactly the same ability to offer its customers bundled and "seamless" end-to-end services as any nonaffiliated IXC, whereas the BOC would acquire an enormous and unchallengeable competitive advantage if allowed to operate its local and long distance businesses on a fully integrated basis.

14. Verizon was alone among the BOCs in providing Declarations in support of its various factual claims. Verizon's Declarant Steven G. McCully testifies as to the handicaps under which he contends Verizon must operate in serving large ("enterprise") customers due to the Section 272(b)(1) "operate independently" requirement and, specifically, the FCC's interpretation of Section 271(b)(1) as referring specifically to Operations, Installation and

36. Selwyn Declaration, August 5, 2002, at paras. 26-27.

Maintenance ("OI&M"). SBC advances similar claims, but without testimonial support.[37] Although Verizon and SBC focus primarily upon large business customers, USTA more generally asserts (but also without advancing any factual or testimonial support) that "... consumers suffer when structural separations are imposed because they cannot obtain competitive packages of bundled services from BOCs, similar to those offered by the BOCs' competitor" and that "[c]onsumers are less willing to purchase local services from a BOC and long distance services from a BOC affiliate when they can purchase both of these services from one provider, the BOC's competitor."[38] These contentions as to what "customers prefer" or what "customers are less willing" to do are offered by the BOCs without any market research or other factual support. Moreover, the enormous success that Verizon and SBC have enjoyed in capturing "consumer" market share specifically by offering "one-stop shopping" for local and long distance clearly belies USTA's unsupported and unsupportable contentions that the presence of the Section 272 structural separation requirement precludes the BOCs from engaging in such "one stop shopping" marketing strategies.

15. Both Verizon and SBC argue that they are particularly handicapped by the OI&M requirements of Section 272(b)(1), basing this claim mainly upon alleged difficulties they encounter in serving large business accounts. SBC asserts, again without factual or testimonial support, that:

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37. SBC Comments, at 7-8.

38. USTA Comments, at 7.

> ...if SBC offers a business customer service connecting its Dallas and Houston locations – the SBC BOC cannot, unlike AT&T or some other interexchange carrier, offer one end-to-end serving arrangement to its customer. Rather, SBC offers three different serving arrangements: one intraLATA arrangement from Dallas to the 272 affiliate's point of presence (POP), a second interLATA arrangement that belongs to the 272 affiliate, and a third intraLATA serving arrangement from the 272 affiliate's POP to the Houston location. This arrangement complicates the design and ordering process, as well as coordination and installation for a customer who believes that it is receiving service from a single agent.[39]

and claims that

> ... SBC's customer cannot receive end-to-end testing from either the BOC or the section 272 affiliate. Thus, if the customer calls in with a trouble report, the BOC cannot simply test across the network and determine the problem. Instead, it has to take the following steps: determine whose side of the network has the problem; if the problem is in the long distance network, send a trouble report to the 272 affiliate; give the affiliate time to work out the problem; ask for status updates from the affiliate; and then inform the customer about the status. Any other provider today can take one trouble report, test the circuit across the network, and inform the customer right away of the problem. Although SBC can do end-to-end testing today with other interexchange carriers like AT&T and Sprint to provide their long distance customers with seamless service, the Section 272 restrictions prevent SBC from providing this service to its own customers. These requirements deny consumers one of the fundamental benefits of the Act: the ability to achieve seamless end-to-end service from one provider.[40]

Verizon makes a similar argument:

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39. SBC Comments, at 8-9.

40. *Id.*, at 9.

> The OI&M restriction puts Verizon at a significant disadvantage in competing with carriers that are able to offer an integrated service platform using their own local and long distance facilities. For large business accounts, many of Verizon's competitors provide their own transmission facilities directly to the customer's location, seamlessly integrating "local" and "long distance" networks and using a single workforce to respond to installation and repair requests. For example, CLECs use their own fiber-based last-mile facilities to serve the vast majority of their large business customers. *See UNE Fact Report*, p. IV-1. In serving large accounts, Verizon cannot respond as a single team that can maintain end-to-end service. ... The section 272 rules result in a set of hand-offs of customer requests for service and repair that lead to less than optimal results. ... The long distance and BOC work groups must transfer responsibility to each other as they try to verify the location of a problem and resolve it. This hinders Verizon in responding to service issues and in meeting the level of service quality that those customers expect.[41]

However, and specifically with respect to so-called "enterprise services" being provided to large business customers, what is relevant — and what is expressly *not* being claimed by Verizon or supported by the "study" to which it refers — is the percentage of CLEC customer *locations*, not *customers*, that are being served by CLEC-owned facilities. And that percentage — particularly for large, multi-location "enterprise" customers — is likely to be extremely small. So even if "CLECs use their own fiber-based last-mile facilities to serve the vast majority of their large business *customers*" as Verizon claims, Verizon does not cite or

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41. Verizon Comments, at 19-20. Citation to *UNE Fact Report* in original. The *UNE Fact Report* to which Verizon refers was prepared for USTA and was submitted by Verizon with its April 5, 2002 Comments in CC Docket 01-338 (*Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*). Significantly, the *UNE Fact Report*, either at the cited Section IV or elsewhere, provides no support for Verizon's assertion that "CLECs use their own fiber-based last-mile facilities to serve the vast majority of their large business customers."

offer any evidence that CLECs use their own fiber-based last-mile facilities to serve the vast majority of their large business *customers' service locations*.

16. The specific competitive challenge being claimed by the BOCs — that their competitors "are able to offer an integrated service platform using their own local and long distance facilities" — exists only in the extremely limited number of individual customer locations at which the BOCs' competitors actually *own* their own local service or other "last mile" network assets. Where the competing IXC or CLEC is ultimately dependent upon BOCs or other ILECs for such facilities, *it is in exactly the same position as a BOC's 272 affiliate in providing "end-to-end service" to a customer*. For example, if an individual "enterprise" customer requires service at one hundred locations in Verizon's operating areas and the largest CLEC owns facilities to only five of them, then in serving that customer the CLEC will still be dependent upon Verizon for 95% of the customer's sites. In those situations, the CLEC has no greater ability to "take one trouble report, test the circuit across the network, and inform the customer right away of the problem" than would the BOC's 272 affiliate purchasing access services or UNEs from the BOC under tariff. Thus, the proper basis for determining exactly who — BOCs or competing carriers — will actually be operating at a competitive disadvantage — and something that none of the BOCs discusses — would be to compare the percentage of customer locations that a BOC would be able to serve end-to-end if the existing Section 272(b)(1) OI&M restriction is permitted to sunset vs. the percentage of customer locations that CLECs are actually today able to serve end-to-end using their own facilities. USTA's *UNE Fact Report* provides no "facts" pertinent to this question.

17. Evidence previously presented to the Commission by AT&T confirms the fact that in the vast majority of cases AT&T must rely upon ILEC-provided loop or entrance facilities to serve its customers:

> AT&T accesses the vast majority of its customers via DS0 (*i.e*. copper pairs), DS1 and DS3 loops leased from the ILEC, to which AT&T connects at collocated space in ILEC central offices.[42]
>
> * * *
>
> With respect to loop facilities to individual buildings, however, it should come as no surprise that alternatives to the ILEC are rarely available. AT&T estimates that there are over 3 million buildings or business locations nationwide. In stark contrast, AT&T has been able to provide direct (*i.e*., non-ILEC) access to slightly more than **[proprietary begin] **** [proprietary end]** buildings. Moreover, where AT&T has built its own facilities into a building, in only about **[proprietary begin]** ********* **[proprietary end]** of cases will AT&T be in a position to use its own facilities to serve all customers in the building that seek service from AT&T. *Bottom line, AT&T reaches only a fraction of a percent of all commercial buildings using non-ILEC facilities and, of those, only a minority are a configuration that provide unrestricted building access using AT&T's own facilities.* Given that ILECs have access to virtually all buildings right now, the situation described hardly supports a finding that reasonable alternatives exist outside the ILEC network and that robust facilities-based competition exists.[43]

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42. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-339, 96-98, 98-147, Declaration of Michael E. Lesher and Robert J. Frontera on behalf of AT&T Corp., at para. 20.

43. *Id.*, Declaration of Anthony Fea and Anthony Giovannucci on behalf of AT&T Corp., at para. 66, emphasis supplied.

18. Moreover, a study recently conducted and submitted to the Commission by the Ad Hoc Telecommunications Users Committee ("Ad Hoc"), a group of large corporate telecommunications users that participates frequently in FCC proceedings (Ad Hoc members are precisely the type of "enterprise" customer to which Verizon's Declarants refer), confirms AT&T's experience as a competitive service provider while totally undermining the BOCs' claims. In its Comments in CC Docket 01-337, the Commission's *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services,* Ad Hoc reports the results of a study of Committee members' use of competing (i.e., non-ILEC) local services, specifically addressing their geographic availability.[44] The Ad Hoc study found that:

> Despite being among the largest and most technologically sophisticated users of telecommunications services in the country, the members of the Ad Hoc Committee report that they face no competitive alternatives to ILEC services to meet their broadband business services requirements in the overwhelming majority of their service locations. Even where competitive alternatives are nominally "available," members are able to make little use of those competitor services, for a variety of reasons.
>
> Committee members aggregated their company-specific information regarding the number of customer locations with broadband service needs falling into each of the four following categories:
>
> - Category A: Capacity of 12 DS-0 channels or less (*i.e.*, ½ T-1, 760 kHz, xDSL, etc.).

44. *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, Comments of the Ad Hoc Telecommunications Users Committee, March 1, 2002, at 14-16. The Declarant participated in the drafting of the Ad Hoc Committee's Comments.

- Category B: Capacity of at least one but not more than four DS-1 circuits.

- Category C: Capacity greater than four DS-1 circuits, or at a level sufficient to justify the provision of at least one DS-3 facility, other than SONET or Optical Carrier ("OC") service.

- Category D: SONET or OC service.

Committee members were then asked to provide estimates of the percentage of locations by category for which they were aware of the presence of viable competitive alternatives to ILEC services. Finally, members were asked to estimate the percentage of locations by Category at which they currently used a competitive carrier to satisfy their service requirements. The total number of locations surveyed was about 30,000.

The results of the survey demonstrate that viable competitive alternatives are not frequently available, particularly with respect to smaller business service locations. [*Footnote*: The survey asked respondents to indicate whether there were viable competitive alternatives for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.] For the overwhelming majority of Category A and B business service locations, viable competitive alternatives to the incumbent LEC's data service were available at less than 10% of locations. The vast majority of the Category C business service locations also appear to have very few viable competitive alternatives. Although some members indicate the presence of some competitive alternatives for seldom-purchased Category D services, others indicate that viable competitive offerings are no more prevalent for the highest capacity services than for the lowest.

As would be expected, the existence of few viable competitive alternatives has resulted in few actual purchases of competitive data services by Ad Hoc's members. [*Footnote*: The survey asked respondents to indicate whether they purchased data services from competitive carriers for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.] Members indicate that in all Category A locations and nearly all Category B locations, fewer than 10% are served by competitors. The majority of Category C and D locations also are served by competitors less than 10% of the time.

Assuming that the members of the Ad Hoc Committee are representative of the large business customers being targeted by Verizon and SBC's "enterprise customer" affiliates, and there is no reason to believe that they are not, with respect to the overwhelming majority of individual service locations, those BOC affiliates are today in exactly the same position as non-BOC IXCs with respect to their need to obtain local access and other local services for such customers from BOCs. By contrast, allowing the OI&M restrictions to sunset would afford the BOCs' "enterprise business" units the unique ability to serve most of their large business customers' locations on a fully integrated basis, which is something that *no IXC or CLEC* is even remotely close to being able to do now or in the foreseeable future.

19. A BOC's Section 272 affiliate, in its capacity as an interexchange carrier, has exactly the same ability to provide both intraLATA and interLATA services to its customers as any non-BOC IXC, such as AT&T or WorldCom. If in the course of doing so the 272 affiliate is required to obtain intraLATA facilities from the BOC's local service entity (e.g., "one intraLATA arrangement from Dallas to the 272 affiliate's point of presence (POP) [and another] ... intraLATA serving arrangement from the 272 affiliate's POP to the Houston location"), *that is no different from what any nonaffiliated IXC would also need to do in order to provide an end-to-end service to a retail customer*. Just as AT&T (as an IXC) can offer its customers end-to-end services by combining access services purchased from BOCs with interexchange network facilities owned by AT&T, so too can the SBC or Verizon 272 affiliate (as an IXC) offer its customers entirely comparable end-to-end services *on an entirely equivalent basis*. Moreover, just as a non-affiliated IXC is *allowed* to own the facilities

interconnecting its customers' premises with its POPs, in which event the IXC can perform full end-to-end testing and provide "seamless" end-to-end services *with respect to those specific circuits*, the BOC 272 affiliate is also "allowed" to own "last mile" facilities, just like any other IXC. The fact set under which the OI&M restriction would place BOCs at a competitive disadvantage is one in which non-BOC carriers owned *extensive*, near-ubiquitous collections of "last mile" assets. Under any other set of market conditions — and it is that "other" set of conditions that actually prevails here — elimination of the OI&M restriction would afford the BOCs a level of competitive advantage as formidable and pervasive as that which led to the break-up of the former Bell System.

20. The local and access market is not competitive, and IXCs not affiliated with BOCs are in the vast majority of cases placed in precisely the same position as are the 272 affiliates with respect to the requirement to purchase access services from BOCs. In fact, if the 272 affiliate is truly operating "at arm's length" vis-a-vis the BOC (as it is required to do pursuant to Section 272(b)(5)), then it would have the same opportunity and incentive to use "competitive" "last mile" facilities where available and where priced below the BOC's tariffed (or non-tariffed) rate.

21. If the requirement for full OI&M separation is eliminated, then the BOC IXC business unit, which would then be integrated into the BOC, would be in a position to — and undoubtedly would — obtain superior access to the intraLATA segments relative to what would be available to nonaffiliated IXCs. As I noted in my Declaration accompanying

AT&T's opening Comments,[45] this is essentially the same situation as has arisen in the case of intraLATA services, where BOCs do not make use of the same "access services and facilities" that are provided to IXCs, thus making the imputation "safeguard" simply not sufficient to protect the IXC from highly discriminatory BOC conduct.

22. Verizon claims that "[t]here is no regulatory need for this [OI&M] restriction."[46] Verizon notes that the Commission was concerned about its ability to ensure that BOCs are correctly allocating costs for services provided to the 272 affiliate, but argues that allocating costs for OI&M functions is no different than allocating costs for the administrative and other services currently provided by the BOC to its affiliate.[47] Verizon contends that the Commission "should eliminate the prohibition on sharing OI&M services immediately for all BOCs regardless of whether the separate affiliate rules have sunset or not in any particular state."[48] In advancing this position, Verizon grossly oversimplifies the reasons for the OI&M restriction as outlined in the *Non-Accounting Safeguards Order* and similarly oversimplifies the cost allocation concern. In that ruling, the Commission concluded that:

> ... allowing the same personnel to perform the operating, installation, and maintenance services associated with a BOC's network and the facilities that a section 272 affiliate owns or leases from a provider other than the BOC would

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45. Selwyn Declaration, August 5, 2002, at paras. 35-36.

46. Verizon Comments, at 17.

47. *Id.*

48. *Id.*, at 21.

> create the opportunity for such substantial integration of operating functions as to preclude independent operation, in violation of section 272(b)(1).[49]

From many years' experience in dealing with BOC provision of *intraLATA* services in competition with IXCs, we now know that in providing such competitive services (and they have been deemed "competitive" and have been detariffed in a number of states), the BOCs do not themselves utilize the same type of "access services" that are provided to competing (nonaffiliated) IXCs. For example, a number of BOC intraLATA toll calls are completed over direct end office-to-end office trunks or through a single tandem. When the same call is routed via an IXC, two separate access tandem connections are almost always required, typically involving additional switching and transport *for which the IXC pays*. BOCs have regularly argued in state PUC imputation proceedings that they should be permitted to impute the cost of the actual facilities they use, not the price that they charge IXCs for the facilities that IXCs use. They have also argued that any such imputation should be made in the aggregate across all categories of interexchange services, not on a service-by-service basis.[50] Under that theory, a particular service could fail imputation so long as another service passed the "imputation test" by an amount sufficient that, taken together, the two in aggregate satisfied the imputation requirement. Thus, the BOC could use profits from intraLATA toll, for example, to cross-subsidize interLATA toll, so long as the two services taken together nominally satisfy imputation. Along the same lines, a BOC could offer a flat-rated toll

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49. *Non-Accounting Safeguards Order*, at 21984.

50. *See* Selwyn Declaration, August 5, 2002, at fn. 83.

service[51] that by itself does not satisfy the imputation requirement, so long as profits from other by-the-call services provide sufficient contribution above access charges so that these two service categories, in aggregate, satisfy imputation. Since imputed access charge "payments" do not actually "cost" the BOC anything above the incremental costs of the access services themselves, imputation rules *per se* are not sufficient to prevent a BOC from engaging in price squeeze tactics.

23. If BOCs are permitted to provide interLATA and local services on a fully integrated basis, they will not use "access services" at all, and will gain enormous competitive advantage over competing interLATA service providers. BOCs might then argue that any imputation requirement should be applied across all interexchange services (intraLATA and interLATA) in aggregate, creating the potential for inter-service cross-subsidization where the extent of actual competition differs from market to market. Additionally, the elimination of the separate affiliate requirement will make it all but impossible to actually track the costs that are being "assigned" to such competitive services, costs that are supposed to be added to the "imputed" access charges to determine whether the imputation requirement has been met.

24. The BOCs' core position here is that they should be permitted to operate their *competitive* businesses (interLATA toll) *incrementally* with respect to their core monopoly

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51. Verizon New England offers its Massachusetts residential customers a flat-rated LATA-wide unlimited calling plan as well as optional extended calling plans to provide flat-rate calling to points that would otherwise be subject to toll charges; Verizon New Jersey offers "Selective Calling Service" whereby residential customers can obtain 20 hours of calling to specified ("selected") exchanges for a flat monthly charge.

local service business. Under this theory, the captive local service customer pays the entire cost of all jointly-used network facilities and organizational resources. We have already seen examples of this philosophy with respect to the attribution of "joint marketing" costs to the 272 affiliate, with only the small increment of time that the service representative spends dealing with long distance service being "charged" to the affiliate.[52] Competition under such conditions cannot be expected to survive for very long.

The BOCs have grossly exaggerated the costs of structural separation, and have offered no factual support whatsoever for the notion that such "costs" exceed the substantial public benefit that continued application of Section 272 would produce.

25. All of the BOCs claim that the Commission has previously determined that *nonstructural* safeguards are *always* preferable to structural separation as a means for protecting competition and competitors from anticompetitive BOC conduct, and contend that the Section 272(a) separate affiliate requirement is a short-term transitional policy that Congress assumed would be eliminated very quickly, specifically, at the end of three years following a BOC's receipt of Section 271(d) in-region interLATA authority in any one of its states.[53] They cite *Computer III*'s finding that "inefficiencies and other costs to the public associated with structural separation significantly outweigh the corresponding benefits" and on

52. As noted in Selwyn Declaration, August 5, 2002, at fn. 88-89, Verizon New York charges Verizon Long Distance $7.71 per customer contact, while SBC Telecom charges SBCLD $9.90 per customer acquisition.

53. Qwest Comments, at 5-6; SBC Comments, at 5; BellSouth Comments, at 19; Verizon Comments, at 9.

that basis contend that the separate affiliate requirements applicable to BOC in-region long distance service should be eliminated forthwith.[54] With respect to the statements in *Computer III* upon which the BOCs rely, it is my understanding that these have not been upheld on appeal.[55] Moreover — and this goes directly to the "cost/benefit" analysis — because of the enormous size of the long distance market (some $110-billion annually), the dollar magnitude of the potential competitive harm that can arise so vastly exceeds the harm that the BOCs could have inflicted in the *Computer III* context as to render the prior cost/benefit comparisons of no current relevance. In addition, the provision of many of the "competitive" services addressed by *Computer III* did not and do not involve the same kind of "bottleneck" services and facilities for which IXCs and CLECs are today utterly dependent. In the case of customer premises equipment ("CPE"), once the FCC adopted the Part 68 "equipment registration" program in 1977 and 1978,[56] the Radio Shacks, K-Marts, and thousands of other retail outlets could freely sell consumer CPE — and any number of business phone system providers could freely sell key systems and PBXs — without any

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54. *Id.*, citing *Amendment of Section 64.702 of the Commission's Rules and regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof; Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, Report and Order, 104 FCC 2d 958, 986.

55. *California v. FCC*, 39 F.3d 919, 930 (9th Cir. 1994) (as in prior orders, "the FCC has similarly failed to provide support or explanation for some of its material conclusions regarding prevention of access discrimination," and thus its "cost-benefit analysis is flawed").

56. *Proposals for New or Revised Classes of Interstate and Foreign Message Toll Telephone Service (MTS) and Wide Area Telephone Service (WATS)*, Docket no. 19528, *Memorandum Opinion and Order*, Rel. June 20, 1977, 64 F.C.C.2d 1058; *Third Report and Order*, Rel. April 13, 1978, 67 F.C.C.2d 1255.

concerns as to their or their customers' ability to interconnect those products with the public telephone network. (Put simply, the CPE "bottleneck" problem was entirely solved by the simple adoption of the standard "RJ-11" plug and jack — and consumers and CPE providers don't even have to buy their RJ-11 jacks from the phone company, because the Commission had also deregulated another CPE-related bottleneck — inside wire).

26. Except for Verizon, which provides three short declarations consisting almost entirely of unsubstantiated opinion with no hard, quantitative facts, none of the BOCs offer any substantive evidence in support of their "inefficiencies" contention. The Fred Howard declaration (for Verizon) recites his estimate of the costs that Verizon Global Networks ("GNI") has incurred and will continue to incur in order to comply with the separate affiliate rules of Section 272. According to Mr. Howard, "GNI has incurred approximately $195 million in capital costs and $314 million in expenses, including depreciation on capital, from 1998 through 2002 to meet section 272 requirements."[57] He goes on to report that "GNI will incur an additional $550 million in expenses from 2003 to 2006 to continue to meet these requirements."[58] He claims that "[i]f the Commission's section 272 rules sunsetted in 2002, ... a conservative estimate of the savings that could be obtained over the 2003 through 2006 time period by re-integrating operations with the BOC where it was economically advantageous to do so is about $247 million."[59] Because his "expense" figures included

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57. Verizon Comments, Declaration of Fred Howard at 1-2.

58. *Id.*

59. *Id.*

depreciation, there is some double-counting as between his “capital cost” and “expense” figures. Mr. Howard’s analysis included switches and transmission facilities, administration, land and buildings, servers, computers and capitalized software, NOC, OSS, and laboratory test systems. For expenses, Mr. Howard included “outside contractors, such as those providing field technicians, that would normally have been staffed by BOC employees, staff and administrative employees, leased transmission facilities, OSS, network operations, NOC, back office functions and miscellaneous.”[60] No supporting documentation in provided to back up the quantitative figures that Mr. Howard recites. It is unclear how he accounted for all of these things — since several of them include services that are being provided by the BOC under contract with its Section 272 affiliate (i.e., for which the BOC is itself an “outside contractor” to the affiliate).

27. SBC makes similar claims: “SBC estimates that integration of long distance and local operations for the Southwestern Bell [] region would result in savings of 50 percent for personnel in the network engineering, customer care, billing, and network operations departments.”[61] As with Verizon’s contentions, SBC offers no factual support, cost study, or other backup for the figures that it presents. Unlike Verizon, SBC does not even provide a Declarant to attest to its claims. On its face, SBC’s contentions are ludicrous. First, “customer care” and “billing” are not even included within the OI&M restrictions, and in fact

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60. *Id.*

61. SBC Comments, at 7.

SBCLD purchases these services from one or more of its BOCs.[62] There is no basis to expect that eliminating the OI&M "operate independently" requirement would produce any consequential savings in these areas. With respect to the "duplication" of personnel and network facilities that SBC claims the OI&M restriction imposes, SBCLD, like any nonaffiliated IXC, may purchase access services and, in certain cases, UNEs *under tariff* from one of the SBC BOCs; nothing in Section 272(b)(1) *requires* SBCLD to construct facilities or engage additional personnel where these functions can be provided by the BOC either as access services or, where permitted, as UNEs. Incredibly, SBC even suggests that elimination of the OI&M restrictions would produce savings in Human Resources, Regulatory, Legal and Accounting, when in fact SBCLD may, and I believe actually does, purchase these support services either from one or more SBC BOCs or from other SBC affiliates.[63] SBC's various claims as to the "costs" of structural separation or the "savings" that would arise if the requirement is allowed to sunset are simply not credible, and should be discounted by the Commission.

28. It is noteworthy that, while here advising this Commission that structural separation has created and will continue to engender extraordinary costs that would not exist in its absence, Verizon's August 12, 2002 10-Q filing with the Securities and Exchange Commission ("SEC") makes no mention of the $1-billion or so of cost about which Mr.

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62. http://www.sbc.com/PublicAffairs/PublicPolicy/Regulatory/affdoc/SWBTtoSBLDrev.doc accessed 8/23/02.

63. *Id.*

Howard testifies. However, that same *CEO-certified* 10-Q does disclose some $2-billion in costs through 2002 for "integrating systems, consolidating real estate and relocating employees," among others, stemming from the 2000 GTE-Bell Atlantic merger that formed what is now known as Verizon. The Company also disclosed that some $500-million out of that $2-billion total was spent "on advertising and other costs to establish the Verizon brand."[64] Yet that same 10-Q makes no reference to any of the alleged extraordinary costs that Verizon's Declarants ascribe to the Section 272 separate affiliate requirement or claim would be avoided by its sunset, despite the fact that, according to Verizon's Declarants here, the general order-of-magnitude of those costs is the same as that for the "integration" costs that Verizon has disclosed in its SEC filing. Moreover, while Verizon is here advising the FCC that the requirement to maintain separate affiliates imposes costs, its disclosure to the SEC suggests that *integration* of what had been separate enterprises engenders even greater cost.

29. Verizon makes the particularly remarkable claim that separate billing of local and long distance is a significant expense: "Verizon estimates that approximately $91 million of incremental billing expense could be avoided through 2006 if long distance charges were included as part of the BOC's bill for local and toll services."[65] The footnote states that "[t]his is based on the costs of publishing separate long distance affiliate pages in the

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64. Verizon August 12, 2002, 10-Q, at Note 2 "Merger Charges and other strategic actions."

65. Verizon Comments, at 10.

customer's bills for local exchange service minus the mark-up in the billing and collection contract."[66] No support is provided for this cost figure, but on its face it would certainly appear to be a gross exaggeration. For example, if one assumes an average of 10-million Verizon long distance customers over the seven-year period from 2000 through 2006, and assume that each monthly bill for each of those customers required one additional page (due to the separate affiliate billing requirement), then that would represent a total of 840-million "extra pages" of billing. Note that the principal addition here is the paper, because the same overall number of individual call-detail line items would still have to be printed whether separate affiliate or integrated billing is involved. Verizon uses two-sided printing for its billing to residential and small business customers, so the 840-million additional "pages" represent an average of 420-million extra sheets of paper. The "extra" page is a worst-case scenario, since the inclusion of the intraLATA and interLATA billing on a combined basis will often require more than one page anyway, so that in those cases the "separate" billing would not involve "publishing" any additional pages or using any additional paper. Additional postage would almost never be required. At $91-million, this would work out to about 21 cents per sheet of paper. Put another way, if one assumes, more realistically, an incremental cost of about 1/2 cent per sheet of paper, the "additional cost" of separate affiliate billing over those seven years would more likely be in the range of about $2.1-million, or about $300,000 per year. In suggesting that its estimate is net of the "mark-up in the billing and collection contract," Verizon is perhaps attempting to portray this figure as some sort of "incremental" cost. In fact, Verizon has provided no information as to what this

66. *Id.*, footnote 7.

"mark-up" is or how it is computed. Certainly, and at the very least, if the Commission is to find any of Verizon's or SBC's quantifications to be dispositive of its ultimate ruling, it should give weight to the fact that none of these alleged "costs" has been disclosed or even referenced in the BOCs' 10-Q SEC filings, and should in any event require far more detail and far more factual support for all such figures.

As long as BOC prices for switched and special access services remain at multiples of cost, the BOCs retain the ability to discriminate against nonaffiliated carriers and engage in anticompetitive price squeezes with respect to the rivals' services.

30. As the Commission is well aware, switched access prices – both under rate-of-return regulation and subsequently under price caps – were set without regard to underlying costs, and are even today set at multiples of the incremental cost to the BOC of providing switched access service. The anticompetitive consequences of setting switched access prices above cost have been explicitly — and recently — recognized by the FCC in its *CALLS Order*:[67]

> Finally, the reduction in switched access usage charges will promote competition in the long-distance market between BOC affiliates entering this market and IXCs. To the extent switched access usage charges paid by IXCs are significantly above cost, BOC affiliates would have a competitive advantage because they would obtain switching services from the BOCs at cost. By driving switched access usage charges closer to their actual costs more quickly than

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67. *In the Matter of Access Charge Reform*, CC Docket No, 96-263; *Price Caps Performance Review for Local Exchange Carriers*, CC Docket No. 94-1; *Low-Volume Long Distance Users*, CC Docket No. 99-249; *Federal-State Joint Board On Universal Service*, CC Docket No. 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; Eleventh Report and Order in CC Docket No. 96-45, Rel. May 31, 2000, 15 FCC Rcd 12962; 2000 FCC LEXIS 2807 ("*CALLS Order*").

> would occur under the existing price cap regime, the CALLS Proposal will minimize the competitive advantages BOC affiliates would have over IXCs in offering long-distance services while switched access rates were significantly above cost.[68]

Although some progress has been made through access charge reform and other initiatives to bring access charges "closer to cost," the objective of aligning switched access rates with costs has never been achieved — and cost/price disparities extant in intrastate tariffs are in many cases even greater than those applicable to *interstate* access charges.[69]

31. Under integrated operation, the BOCs would be able to double the competitive advantage they have over competitors by (1) avoiding using "access services" *per se*, while (2) continuing to apply excessive prices to the access services that competing nonaffiliated IXCs are forced to use. Specifically, when an IXC provides toll service to a BOC customer, the interexchange carrier must purchase switched access from the BOC in order to originate and/or terminate the call and incur additional network, administration (including billing and collection) and marketing costs in order to provide a "retail" long distance service to its end-

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68. *Id.*, at para. 158.

69. For example, in New Jersey, the per-minute intrastate interLATA switched access rate can be as high as $0.0337 at each of the originating and terminating ends of a call (*See*, Bell Atlantic New Jersey, Tariff BPU-NJ No. 2, Access Service Tariff, Section 3.8, Fifth Revised Page 15; Section 6.8.2(A)(3), First Revised Page 104; Section 6.8.2(C)(3), Original Page 104.1; Section 6.8.3(A), Sixth Revised Page 108 (all effective October 1, 1999 (Interim)). In New York, the per-minute intrastate interLATA switched access rate during the weekday rate period is $0.0290 at each end (*See*, Verizon New York, PSC NY No. 11 - Communications, Access Service, Section 30.3, Original Page 1; Section 30.6.1(A)(4)(a), Original Page 5; Section 30.6.1(C)(2)(c), Original Page 22; Section 30.6.2(A), Original Page 28; Section 30.14, Original Page 66 (all effective September 1, 2001)).

user customers. When a BOC provides retail toll services to one of its end-user customers, the BOC accomplishes precisely the same functions of call origination and call termination that are provided to IXCs in the form of switched access services, but because the BOC is able to integrate these "access" functions with the interexchange switching and transport functions associated with the interexchange portion of the call, its actual out-of-pocket costs are frequently even lower than the "cost" the BOC incurs in providing switched access services to IXCs, and immensely lower than the "price" that those IXCs pay to the BOC for switched access services. From the perspective of the competing long distance provider, access charges are an actual cash out-of-pocket cost, whereas from the perspective of a BOC, any "imputation" of equivalent access charge payments amounts to little more than moving money from one "pocket" to another. As I noted in my August 5 Declaration, the BOCs' own economic experts have concluded that BOCs are "profit-maximizing" with respect to access and retail long distance services *combined*, ignoring entirely any "access charge imputation" requirement.[70]

32. As long as the BOCs are required to provide long distance services through an affiliate that operates independently of and at "arm's length" with respect to their local exchange operations, those affiliates will need to purchase BOC access services in exactly the same form as they are provided to nonaffiliated IXCs, out of the same interstate and intrastate access tariffs, and at exactly the same prices and under exactly the same terms and conditions.

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70. The BOCs' use of "double marginalization" as a pricing strategy, i.e., profit-maximization across the access and interexchange network functions combined, is discussed at para. 49 *et seq.* of my August 5, 2002 Declaration.

If the Commission were to determine that, notwithstanding the “operate independently” and “arm’s length” requirements of Section 272(b), the BOCs and their long distance affiliates were *in fact* engaged in the type of “double marginalization” pricing that Hausman *et al* have described, it would be in a position to take corrective action and in so doing minimize the potential for a BOC-imposed price squeeze upon rival firms. However, if the Commission were to end the requirement that the BOC operate its in-region long distance business out of a separate affiliate, and were no longer to require that the BOC long distance business activity operate independently with respect to, and transact all business at arm’s length with, the BOC’s local exchange operations, the BOC will be then capable of engaging in “double marginalization” pricing and in imposing a price squeeze with respect to access charges and retail long distance rates. The BOC will no longer utilize or pay for its own switched access service *per se*, even though it will be providing the corresponding functionality *for itself* to originate and terminate such calls at its local subscribers' access lines. The BOCs will have thereby obtained a unique competitive advantage that is not available to any competing IXC. Put differently, while the interexchange carriers' profit margin is the difference between the retail long distance service price and *all* of its costs, including the out-of-pocket switched access payments it makes to a BOC, a BOC's profit margin will be the difference between the retail toll price and the BOC's *actual cost* of providing the switched access functionality to itself as part of its retail toll service. The BOC alone has the ability to reap *additional* profits equal to the difference between the cost and retail rate for switched access functionality.

33. Even with the 2001 *CALLS* reductions in switched access charges, BOC access rates are still set at large multiples of cost. The magnitude of the excess of price relative to cost for access services can be roughly estimated by comparing BOC switched access rates with the *TELRIC*-based rates for the same functions when provided as unbundled network elements ("UNEs") that are offered to CLECs for use with their *local* services as required by Sections 251 and 252 of the 1996 *Act*. The *functions* that are involved in providing switched access are *identical* in every material respect to the functions associated with *local switching, tandem switching* and *common transport* that are provided by the BOCs as UNEs at rates that have been determined to be cost-based. For example, even after the *CALLS* access charge reductions, the current price of switched access – roughly $0.0055 per minute at each end of a call[71] – is still nearly eight times the $0.0007 (per end) federal cap on local reciprocal compensation call termination rates as set by the FCC in the *ISP Remand Order*.[72] And, in many states, the gap between in-state access prices and cost for the same local switching and transport functions is even greater.[73]

71. *CALLS Order*, at **355.

72. *Implementation of the Local Competition Provisions in the Telecommunications Act of 996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 96-98; CC Docket No. 99-68, *Order on Remand and Report and Order*, Rel. April 27, 2001, 16 FCC Rcd 9151, 9156.

73. For example, in New York, the first state to obtain Section 271 authority, the current *intrastate* interLATA switched access rate during the weekday daytime rate period is $0.0290 per minute. *Supra*, footnote 69. Thus, Verizon's intrastate access charge in New York may as much as 41 times the $0.0007 per-minute local call termination rate cap established by the FCC in the *ISP Remand Order*.

34. If the tariffed rates for switched access services (as they apply to IXCs) are set at any level *above* the actual cost of providing the service, and assuming that market conditions forced competitors' long distance prices to be set at levels *no greater than* those being charged by the BOCs, competitors will face higher costs than the BOC, and will thus be forced to deal with a decidedly lower — or even a *negative* — profit margin. Thus, the existence of switched access rates at levels substantially above cost permits the BOCs to implement an anticompetitive price squeeze against other toll providers that will ultimately squelch non-ILEC competition for long distance services.

35. There is another related point that should also be addressed. Most of the BOCs argue that the Commission should not be concerned about anticompetitive conduct and cost shifting because the price cap regime extant in the federal arena and in most states does not permit a carrier to increase its prices or revenues (for its regulated services) as a result of cost misallocation. As a result, they claim, the BOCs have no incentive to engage in anti-competitive conduct.[74] In fact, precisely the opposite may be the case. Under rate of return regulation, if the BOC sets the price of an essential service (that is subject to the Section 272(e)(3) imputation requirement) above cost, then its own "imputation payments" would be included in determining the appropriate price level for the remainder of its regulated services. Thus, if the BOC were to set an excessive price, the excess profits resulting from imputation payments would have to be flowed through to its basic service ratepayers in the form of lower prices for other (retail) services. By contrast, under price caps, the BOC has no such

74. Verizon Comments, at 18; SBC Comments, at 10-12; Qwest Comments, at 13.

requirement: It can overcharge its own competitive business unit without being forced to flow-through the excess profits resulting from this strategy; in effect, it will simply be shifting profits from one "pocket" into another. And in other situations, where the inter-affiliate transfer price is not used to establish the cash price that nonaffiliated carriers would pay the BOC for like services (e.g., because the BOC does not provide "like services" to the nonaffiliated carrier — joint marketing services, legal and lobbying services, are good examples), the BOC can *underprice* the services it provides to its affiliate, effectively negating the *overcharge* that it had applied where the transfer price matters (i.e., where it is used as a basis for the cash price that nonaffiliated carriers pay for an essential service). The point is that under "pure" price caps, where the BOC is not subject to any cap on earnings or any obligation to share excess earnings, payments for inter-affiliate transfers have no economic or financial consequence for the corporation as a whole, they amount to shifting money from one pocket to another. And, of course, if the separate affiliate requirement is allowed to sunset, the BOCs will no longer be under any obligation to post or otherwise make public — or for that matter even use — any "transfer prices" applicable to services furnished by the BOC to its (integrated) long distance business activity.

36. Despite SBC's joining in advancing this same "price cap" theory, SBC does admit that it

> does not disagree with the Commission's conclusion in the *Interconnection Order* that there may be forms of discrimination that are imperceptible to end users. ... However, such types of discrimination would not lead to the acquisi-

> tion of market power. Only discrimination that affects the purchasing decisions of large numbers of customers could confer market power.[75]

But that is precisely what would happen if a BOC were to raise the price of an essential facility to supracompetitive levels. Competing IXCs would be forced to increase their own retail prices, permitting the BOC's long distance business unit to either impose a price squeeze on its rivals or, alternatively, to raise its own retail prices as well. SBC's tactic would in fact "affect[] the purchasing decisions of large numbers of customers" and in so doing would "confer market power." Price caps provides BOCs with both a strong incentive and the capability to set prices of essential facilities far in excess of cost, whether or not they are required to "impute" those prices into the retail prices of their own competitive services (e.g., long distance).

37. All of these circumstances, taken together, lead to one inescapable conclusion: Competition for long distance services cannot be assured if the BOCs are permitted to operate on an integrated basis while at the same time extracting economic rents for access services furnished competitors at above-cost prices. Lowering switched access prices to cost-based levels will assure that incumbent LECs and competitive interexchange carriers face identical costs for the underlying wholesale service of providing the first- and last-mile connection between the calling party and the called party, and will thus enhance the opportunity for the development of a competitive market for interLATA toll services. Before the Commission gives any serious consideration to ending the Section 272 separate affiliate requirement for

75. SBC Comments, at 11.

BOC toll services, the Commission should require that all BOCs first set their access charges on the same basis as UNE rates — i.e., at TELRIC levels.

Conclusion

38. Section 272 was inserted into the 1996 *Act* specifically out of concern that a BOC, having reentered the long distance market, would be capable of using its market power in the *local* services market to diminish competition in the adjacent long distance market. Although the BOCs cite to the small losses in market shares that they have sustained over the past six years, those losses do not translate into any substantive diminution of the BOCs' market power. That *fact*, coupled with the BOCs' ability to set access charges at supracompetitive levels well in excess of cost, provides sufficient basis for the Commission to extend the sunset date for the Section 272 separate affiliate requirement.

The foregoing statements are true and correct to the best of my knowledge, information and belief.

LEE L. SELWYN

Exhibit B

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of SBC for Forbearance From the Prohibition of Sharing Operating, Installation and Maintenance Functions Under Sections 53.203(a)(2) and 52.203(a)(3) of the Commission's Rules and Modification of Operating, Installation and Maintenance Conditions Contained In the SBC/Ameritech Merger Order	)	CC Docket Nos. 96-149, 98-141

COMMENTS OF AT&T CORP.

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July 1, 2003

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Pursuant to the Commission's Notice,[1] AT&T Corp. ("AT&T") hereby submits its opposition to SBC's Petition for Forbearance and Modification. SBC seeks forbearance from the "crucial[ly] importan[t]"[2] provisions of section 272 that prohibit SBC from having incumbent local exchange carrier ("LEC") subsidiaries perform "operating, installation and maintenance" ("OI&M") services on behalf of its long distance subsidiary ("SBCLD"). In addition, SBC seeks a waiver of the SBC/Ameritech merger conditions that regulate OI&M services between SBC's incumbent LEC subsidiaries and SBC's "separate" advanced services affiliate ("ASI"). Neither request should be granted.

INTRODUCTION AND SUMMARY

In the *Non-Accounting Safeguards Order*, the Commission concluded "that allowing the same personnel to perform the operating, installation, and maintenance services associated with a BOC's network and the facilities that a section 272 affiliate owns or leases from a provider other than the BOC would create the opportunity for such substantial integration of operating functions as to preclude independent operation, in violation of section 272(b)(1)."[3] In creating this prohibition, the Commission explicitly relied on a principle established when the BOCs were first created – that allowing a BOC to provide network-related services on behalf of an affiliate "would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation."[4] Thus, the Commission concluded that the OI&M prohibition was vital to fulfilling

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[1] DA 03-1920 (June 10, 2003).

[2] *Texas 271 Order*, 15 FCC Rcd. 18354, ¶ 395 (2000).

[3] *Non-Accounting Safeguards Order*, 11 FCC Rcd. 21905, ¶ 163 (1996).

[4] *Id.* (citing *BOC Separations Order*, 95 F.C.C.2d 1117 (1983)) (emphasis added).

section 272's central purpose of "prohibit[ing] anticompetitive discrimination and cost-shifting."[5]

Despite the Commission's repeated recognition of the need for and benefit of OI&M "separation," the BOCs sought reconsideration of the Commission's imposition of the OI&M safeguards in the *Non-Accounting Safeguards Order*, claiming that the Commission's interpretation of section 272 was not mandated by the statutory language, and that it was unnecessary to protect against improper cost allocation or discrimination. The Commission again rejected these claims, reasserting its determination that section 272 precludes shared OI&M services, and recognizing that any other ruling would "create a loophole around the separate affiliate requirement" and would provide for such "substantial integration of these essential functions . . . that independent operation would be precluded."[6]

Developments since the *Non-Accounting Safeguards Order* have only confirmed the need for and utility of strong OI&M rules. In the SBC/Ameritech merger proceeding, the Commission found that the combination of SBC and Ameritech *heightened* the combined entity's "incentive to discriminate" against independent long distance carriers and that this incentive is "particularly acute with regards to advanced or customized access services for which detection of discrimination is most difficult."[7] Moreover, the Commission in that merger proceeding rejected the claim that regulators have developed proper tools to detect and prevent discrimination by the "new" SBC and its BOC subsidiaries: "With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting

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[5] *Id.* ¶ 9.

[6] *Non-Accounting Safeguards Third Order On Reconsideration*, 14 FCC Rcd. 16299, ¶ 20 (1999).

[7] *SBC/Ameritech Merger Order* ¶ 196; *see also id.* ¶¶ 212-35.

discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination."[8] Thus, to mitigate these anticompetitive effects of the merger, the Commission again turned to structural separation. As a condition to consummating its acquisition of Ameritech, SBC was required both to provide advanced services through a separate affiliate "patterned" on section 272 and to provide OI&M services to that affiliate on an arm's-length basis and on non-discriminatory terms and conditions.

SBC's forbearance petition contains no evidence of changed circumstances that could justify repealing the OI&M services restriction required by section 272 or the *SBC/Ameritech Merger Order*. Of course, as a legal matter, that claim is barred section 10(d) of the Communications Act, which explicitly precludes the Commission from forbearing from the requirements of section 271. Section 271(d)(3)(B) expressly provides that the Commission may grant a BOC long distance authority only if the requested authorization "will be carried out in accordance with the requirements of section 272."[9] SBC's Petition would require the Commission to forbear from applying section 271(d)(3)(B), which it is forbidden to do by section 10(d).

In all events, long distance carriers and advanced services providers remain dependent upon SBC and the other BOCs for last mile facilities necessary to access their customers. SBC and the other BOCs therefore retain substantial local market power and the ability and incentive to leverage this market power to undermine competition in the long distance and advanced services market. Hence, section 272's "operate independently" rules in general, and the OI&M

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[8] *Id.* ¶ 220.

[9] 47 U.S.C. § 271(d)(3)(B).

rules in particular, remain necessary to prevent SBC from using its control of bottleneck facilities to raise rivals' costs and prevent long distance and advanced services competition on the merits.

If there were any error in the Commission's original balancing of costs and benefits in this area, it is that is that the Commission *underestimated* the competitive harm arising from shared BOC/272 services, and allowed *too much* sharing of other services. Although the Commission prohibited the sharing of OI&M services, it did not restrict the sharing of many other services necessary to operate SBC's long distance affiliate. As a result, in many areas SBC has the unique advantage of being able to provide service on an "integrated" basis. And according to state commission "performance measures," SBC has used that unique advantage to provide competitive carriers with patently inferior access to essential facilities relative to what it provides itself. At the same time, SBC, notwithstanding OI&M requirements that SBC claims prevent it from competing effectively, has achieved "near 50 percent" penetration of the consumer long distance market in its Southwestern territories.[10] On this record, there can be no serious claim that the joint OI&M prohibition is an unwarranted restriction.

SBC's additional request for a waiver of the *SBC/Ameritech Merger Order*'s OI&M-related conditions is even weaker. Because it was clear that the SBC/Ameritech merger would have otherwise substantially increased the combined entity's incentive and ability to harm competition, particularly for nascent advanced services, SBC and Ameritech proposed the creation of a "separate" advanced services affiliate, ASI, that was modeled on the section 272 long distance separate affiliate. With respect to OI&M, however, the merger conditions expressly permitted the "sharing" of OI&M services between SBC's incumbent operations and

[10] *See* Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

the advanced services affiliate, so long as this sharing is provided on a non-discriminatory basis. Thus, there is simply no way to square SBC's sweeping claims about the costs of the *SBC/Ameritech Merger Order* OI&M conditions with the limited extent to which these conditions restrict the "integration" of SBC's OI&M operations.

Critically, SBC can at any time collapse ASI and fully integrate its advanced services operations with its incumbent telephone operations. The *SBC/Ameritech Merger Order*'s separate advanced services affiliate condition was a temporary one, and subject to "sunset" triggers that have since been met. The obvious question for the Commission then is why does not SBC simply eliminate ASI if the OI&M requirements imposed in the *SBC/Ameritech Merger Order* are so onerous? The answer is buried at the end of SBC's Petition. There, SBC states that the waiver it is seeking should be deemed to have no impact on the Commission's recent holding in the *ASI Forbearance Order* that ASI would be regulated as a non-dominant carrier and excused from tariff filings and related-requirements.[11] But SBC neglects to mention that that this order held that ASI would be excused from dominant carrier regulations only "to the extent" ASI was operated "in accordance with the separate affiliate structure established in [the *SBC/Ameritech Merger Order*]," [12] because these conditions were necessary to prevent the type of market power abuses in which SBC-ASI would otherwise be able to engage absent the tariff filing and related regulations. It is therefore clear that what SBC is really after is the continued benefit of the *ASI Forbearance Order*, but without the protections the Commission relied upon to protect the public interest when it deemed ASI to be non-dominant – protections that are by their terms less onerous than what is required if section 272 were fully applied. The

[11] SBC Pet. at 27.

[12] *ASI Forbearance Order*, 17 FCC Rcd. 27000, ¶ 13 (2002) (emphasis added).

anticompetitive result that SBC seeks is foreclosed by the reasoning of the *ASI Forbearance Order*.

ARGUMENT

I. SBC'S PETITION FAILS TO DEMONSTRATE THE PRECONDITIONS FOR FORBEARANCE FROM THE SECTION 272 OI&M RULES.

For the most part, SBC merely reproduces arguments advanced by Verizon in its August 5, 2002, petition for forbearance from the section 272 OI&M rules. As AT&T explained in its responses to Verizon,[13] the complete answer to SBC's argument is that SBC and the other Bells continue to exercise considerable local market power and can use that power to discriminate against their long distance rivals. Given that the Bells' forbearance petitions would eliminate altogether the OI&M safeguards – and thereby materially weaken the effectiveness of section 272 as a safeguard for preventing the Bells from acting on their incentives to raise rivals' costs – there can be no basis for a finding, as required by section 10 of the Communications Act, that the requested forbearance is consistent with the public interest and the interests of consumers.[14] This is not just the view of AT&T, but the position of every state regulatory commission that has filed comments on this issue.[15]

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[13] *See generally* AT&T's Opposition to Verizon Petition for Forbearance (CC Docket No. 96-149, Sep. 9, 2002); *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, Nov. 15, 2002).

[14] *See* 47 U.S.C. § 160(a).

[15] *See, e.g.*, Washington UTC 272 Sunset Comments (WC Docket No. 02-112, Aug 5, 2002); Missouri PSC 272 Sunset Comments (WC Docket No. 02-112, Aug. 5, 2002); Pennsylvania PUC 272 Sunset Comments (WC Docket No. 02-112, July 22, 2002). Most notably, the Texas PUC has strongly urged the Commission to extend all the section 272 requirements (which would include the OI&M safeguard):

> The Texas PUC believes that . . . SWBT's continued dominance over local exchange and exchange access services still hinders the development of a fully competitive markets. Thus SWBT retains both the incentive and ability to

(continued . . .)

Rather than attempt to show with hard evidence that it has lost market power, SBC rehashes the same arguments it and the other BOCs presented – and the Commission rejected – in challenging the OI&M rule at multiple stages of the *Non-Accounting Safeguards* proceedings.[16] For example, SBC asserts that other non-structural section 272 requirements make the OI&M restriction unnecessary.[17] The Commission has already responded to each of these contentions, and has provided more than adequate support for its interpretation of section 272(b)(1) as precluding shared OI&M functions. Applying traditional rules of statutory construction,[18] the Commission stressed that shared OI&M services would "inevitably" lead to a level of BOC/affiliate integration that was precluded by the operate independently requirement of section 272(b)(1).[19] For example, such shared services "would inevitably afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors."[20] The

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(. . . continued)

> discriminate against competitors and to engage in anti-competitive behavior. . . . . Accordingly, prudence demands that the sunset period be extended until the conditions which necessitated the creation of competitive safeguards no longer exist.

Texas PUC 272 Sunset Comments at 3 (WC Docket No. 02-112, July 25, 2002).

16 *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Second Order On Reconsideration*, 12 FCC Rcd. 8653, ¶ 12 (1997); *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20.

17 SBC Pet. at 15-16.

18 *See, e.g. Non-Accounting Safeguards Order* ¶ 156 (recognizing that this interpretation of operate-independently requirement "is based on the principle of statutory construction that a statute should be construed so as to give effect to each of its provisions"); *id.* (reasoning that the "structural differences in the organization of [sections 272(b) and 274(b)] suggest that the term 'operate independently' in section 272(b)(1) should not be interpreted to impose the same obligations . . . as section 274(b)").

19 *Non-Accounting Safeguards Order* ¶ 163.

20 *Id.*

Commission separately recognized that allowing such shared OI&M services would create "substantial opportunities for improper cost allocation."[21]

SBC dismisses these conclusions, asserting that (despite the Commission's repeated contrary findings) there is nothing unique about OI&M network services that justifies treatment different than other administrative services where the Commission has approve sharing, and that SBC does not and cannot use OI&M service to discriminate against competitors.[22] SBC, however, provides no support for its blanket charge that the Commission was mistaken when it deemed the BOCs' networks, and services directly concerning those networks, fundamentally different than other BOC services. These network facilities are the basis for the BOCs' market power, and are virtually always required inputs for the BOCs' competitors. The Commission has long recognized that network-specific functions are especially susceptible to BOC discrimination with potentially devastating consequences for competitors dependent on these facilities.[23] The Commission likewise long ago recognized the unique opportunities for cost misallocation concerning network services and related expenses.[24] Until SBC's control of bottleneck local facilities dissipates, therefore, the OI&M restriction (like the related bar on joint ownership of network facilities) is a necessary corollary to any requirement that a BOC and its affiliate "operate independently."

Nor are the other requirements of section 272 (such as section 272(e)'s nondiscrimination requirement) or related "performance measures" adequate substitutes for the type of structural

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[21] *Id.*

[22] SBC Pet. at 13-14.

[23] *See, e.g. Non-Accounting Safeguards Order* ¶¶ 158-166.

[24] *See BOC Separations Order* ¶ 70.

separation imposed by the OI&M and other "operate independently" requirements under section 272(b)(1). Enforcement of nonstructural safeguards requires both detection and quick and effective enforcement. Yet the sharing of OI&M that SBC seeks would, as the Commission has concluded since 1983, make detection of misconduct far more difficult. And even if it were discovered, by the time the complaint process had run its course, however, the damage to competitors and competition would be done. SBC in particular has shown a willingness to breach and endlessly litigate enforcement of even the clearest legal obligations, as reflected in the Commission's recent imposition of a record-setting $6 million fine against SBC for having "willfully and repeatedly" violated the "plain" conditions of the SBC/Ameritech merger.[25] Similar repeated violations by SBC led the California Public Utilities Commission, for example, recently to recognize that its "confidence in non-structural safeguards has waned significantly over the last years."[26] This Commission also has elsewhere stressed the need for structural

[25] *SBC Forfeiture* Order, 17 FCC Rcd. 19923, ¶ 1 (2002). As the Commission concluded: "In state after state, throughout the Ameritech region, SBC force competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer, causing delays in the availability of shared transport." *Id.* ¶ 24.

[26] Decision Granting Pacific Bell Telephone Company's Renewed Motion for an Order that it has Substantially Satisfied the Requirements of the 14-Piont Checklist in § 271 of the Telecommunications Act of 1996 and Denying that it has Satisfied § 703.2 of the Public Utilities Code, *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, CPUC Decision 02-09-050, R. 93-04-003 *et al.* at 265 (Cal. PUC, Sep. 19, 2002). Over just the past thirteen months, the California Public Utilities Commission has imposed fines against SBC of $27 million and $25 million – each records when imposed – for anticompetitive and unlawful conduct in California. *See* Final Opinion on Pacific Bell's Marketing Practices and Strategies, *The Utility Consumers' Action Network v. Pacific Bell* (U 1001 C), Case 98-04-004, D.01-09-058 (Cal. PUC, Sep. 20, 2001) ($25 million fine); Presiding Officer's Decision, *The Utility Consumers' Action Network v. Pacific Bell Telephone Company*, Case 02-01-007, (Cal. PUC, Sep. 27, 2002) ($27 million fine, per settlement).

safeguards, because BOCs can discriminate in myriad subtle forms, and it is "impossible for the Commission to foresee every possible type of discrimination."[27]

Indeed, even for the handful of states in SBC's region that have enacted rigorous "performance measures" with self-executing penalties, SBC nonetheless continues to find it advantageous to provide its competitors with poor network access. For example, according to the January 2003 report from the Texas PUC reviewing the effectiveness of the performance measures enacted in Texas, SBC has met the performance benchmarks set by the Texas PUC in only 6 out of 31 months for which data are now available.[28] As of July 2002, SBC had paid over $25 million in fines, an amount that would have been higher but for the fact that the Texas performance measure penalties cap payments in certain months.[29] And with regard to "special access" performance standards, there are none. The Commission has yet to act despite having sought comments almost two years ago as to the type of measures and penalties it should adopt. On this record, there is plainly no evidence to support SBC's claim that sharing of OI&M services would not permit it to discriminate – it already discriminates with the ban in place, and removal of it would only exacerbate the favoritism it provides to its own operations.

SBC's claim that it does not benefit from such discrimination is laughable. SBC states "in the highly competitive long distance and advanced services marketplaces today, no ILEC affiliate could be assured of being the choice for a disgruntled customer, even if that customer

[27] *SBC/Ameritech Merger Order* ¶ 206.

[28] Scope of Competition in Telecommunications Markets of Texas, Report to the 78th Texas Legislature, at 50 (Tex. PUC, Jan. 2003) (available at http://www.puc.state.tx.us/telecomm/reports/scope/index.cfm).

[29] *Id.* at 52.

decided not to use the carrier that was the victim of discrimination."[30] SBC might not be "assured" of winning *every* customer of carriers that (because of SBC's actions) are unable to provide service at prices or quality comparable to SBC, but such discrimination clearly tilts the playing field in SBC's favor. Further, to the extent that all carriers depend on access to SBC's facilities, SBC has the potential ability to raise the costs of *all* of its rivals and thereby make it a near certainty that it will gain the lion's share of disaffected customers.

Finally, SBC claims that structural safeguards like the OI&M restriction are unnecessary because it typically operates under price-cap regimes and thus has no incentive to misallocate the costs of its competitive services to regulated accounts.[31] As AT&T has demonstrated, price caps can, in fact, *increase* the incentives for cost misallocation.[32] Under a price cap regime, a BOC has freedom to shift profits from one affiliate "pocket" to another without ever being forced to pass through "excess" profits to regulated customers.[33] Thus, for example, SBC could overcharge its section 272 affiliate for services it also provides to competing long distance carriers (and thereby set an unfairly high rate for competitors under section 272(e)), while separately undercharging the affiliate for services it does not provide to competitors, all without a concern about how such pricing would impact the rates it charged regulated customers.

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[30] SBC Pet. at 15. Nevertheless, SBC and other BOCs have implemented aggressive "win-back" programs, including marketing materials that seek to persuade customers that BOCs have higher service quality than new entrants.

[31] SBC Pet. at 11-12.

[32] Reply Declaration of Lee Selwyn on behalf of AT&T Corp., ¶¶ 35-36 (CC Docket No. 02-112, Aug. 26, 2002) ("Selwyn Reply Dec."); *Ex Parte* Declaration of Lee Selwyn on behalf of AT&T Corp., ¶¶ 43-44 (CC Docket No. 96-149, Nov. 15, 2002).

[33] Selwyn Reply Dec. ¶ 35.

II. SBC'S FAILS TO JUSTIFY A WAIVER OF THE *SBC/AMERITECH MERGER ORDER*.

SBC asks the Commission to eliminate "the provisions of the *SBC/Ameritech Merger Order* that restrict the sharing of OI&M services" with respect to ASI.[34] This request is as ironic as it is unlawful. As noted, the conditions that SBC now attacks were *proposed by SBC itself* in order to remedy the severe anticompetitive effects of its merger with Ameritech.[35] Because the SBC/Ameritech merger increased the likelihood that the combined entity would discriminate against rivals in "advanced services" and other markets,[36] SBC proposed the creation of a "separate" advanced services affiliate patterned on the requirements of section 272.[37] SBC maintained that creating a separate advanced services affiliate that would have to deal at arm's length with SBC's incumbent LECs in the same manner as competitive carriers would "spur competition in the advanced services market" and "insure the maintenance of a level playing field."[38]

The conditions governing the sharing of OI&M between SBC's incumbent LECs and its advances services affiliate undeniably were (and are) central to the effectiveness of this separate advanced services affiliate scheme. As SBC explained, the OI&M-related conditions that it proposed require it "to provide the same quality service to [CLECs] as it does the affiliate, and a CLEC can readily compare its service with that of the separate affiliate to make sure it is being

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[34] SBC Pet. at 2.

[35] *SBC/Ameritech Merger Order* ¶ 45.

[36] *Id.* ¶ 196

[37] *Id.* ¶¶ 363-370.

[38] Joint Reply of SBC Communications and Ameritech Corp., to Comments Regarding Merger Conditions, at 73-74 (CC Docket No. 98-141, July 26, 1999).

treated fairly."[39] SBC also agreed with commenters that the conditions that it initially proposed should be strengthened to provide even greater transparency with respect to transactions between SBC's incumbent LECs and its advanced services affiliate.[40]

The Commission codified SBC's proposed conditions in its order approving the SBC/Ameritech merger. In so doing, the Commission found that requiring SBC's incumbent LECs to provide network services, including OI&M services, to the separate advanced services affiliate only on an arm's-length and nondiscriminatory basis would maintain the "level competitive playing field" that would otherwise be irreversibly tipped by the merger.[41] The Commission furthered recognized the critical importance of the OI&M protections when it required SBC to "to provide unaffiliated carriers with the same OI&M services that its retail operations use, as well as those OI&M services that were previously made available " even *after* the general separate advanced services affiliate conditions sunset.[42]

By forcing SBC to treat its advanced services affiliate "like a CLEC," the merger conditions both reduced the ability of SBC to give ASI preferential access to bottleneck local facilities and increased the ability of the Commission, state agencies, and competitive carriers to monitor and detect such market power abuses. Not a thing has changed that could reduce the need for these important protections. Competitive carriers in SBC's incumbent territories still have no alternative but SBC for the local loops and collocation necessary to provide data

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[39] *Id.* at 78.

[40] SBC *Ex Parte* Letter at 4 (CC Docket No. 98-141, Aug. 27, 1999) (revised conditions will ensure that "CLECs gain the benefit of having transactions between the incumbent LEC and the separate affiliate be open and available for review").

[41] *SBC/Ameritech Merger Order* ¶ 363.

[42] *Id.* ¶ 368.

services such as DSL (and hence the voice/DSL bundles that many customers now demand). If anything, the need for regulation in this area is stronger in light of the collapse of the "data" LEC industry and the almost total loss of intramodal data competition.

And just months ago SBC (and the Commission) *expressly relied* upon the continued existence of the OI&M merger conditions as the basis for forbearing from applying dominant carrier regulation to ASI. In the *ASI Forbearance Order*, the Commission held that it would decline to impose dominant carrier regulation on ASI's services "*to the extent* that SBC operates in accordance with the separate affiliate structure established in th[e] [*SBC/Ameritech Merger Order*]."[43] By definition, if the Commission were to waive any aspect of the advanced services separate affiliate requirements imposed in the *SBC/Ameritech Merger Order*, SBC would no longer be operating "in accordance with the separate affiliate structure *established in that Order*,"[44] and ASI would no longer qualify for the non-dominant status that was conferred upon it the *ASI Forbearance Order*. Thus, SBC is plainly wrong in arguing that the *ASI Forbearance Order* has no bearing on the relief SBC requests here.[45]

Indeed, the Commission expressly rejected SBC's "forbearance request to the extent that it argues that lesser safeguards would suffice in the event it were to change its affiliate structure." *Id.* ¶ 30. That is because the evidence SBC proffered to show the lack of need for dominant carrier tariff protections was performance data generated over a time period in which SBC/ASI

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[43] *ASI Forbearance Order* ¶ 13 (emphasis added); *see also id.* ¶ 28 ("given the separate affiliate structure established in the *SBC/Ameritech Merger Order* and SBC's commitments in this record, subjecting the rates, terms, and conditions under which ASI provides advanced services to our dominant carrier tariffing process is more likely to impede, than promote, competition.").

[44] *Id.* ¶ 13 (emphasis added).

[45] SBC Pet. at 27.

was governed by the OI&M conditions of the *SBC/Ameritech Merger Order*.[46] Further, the Commission expressly relied on the existence of the *SBC/Ameritech Merger Order*'s OI&M non-discrimination safeguards in its analysis of whether forbearance was in the public interest and whether other protections were necessary in the absence of tariff filing requirements.[47] For these reasons, if ASI were allowed to operate under "lesser safeguards" than those found sufficient to protect the public interest in the *ASI Forbearance Order*, there would be no basis for concluding that dominant carrier tariff regulations are unnecessary going forward.

But even if SBC's hypocrisy could be ignored, the limited burden imposed by the merger conditions cannot. In stark contrast to the OI&M rules the Commission adopted governing long distance affiliates, the *SBC/Ameritech Merger Order* expressly permits SBC's incumbent LEC subsidiaries to perform "operations, installation, and maintenance functions" on behalf of its "advanced services affiliate."[48] Rather than banning "shared" OI&M services, as the Commission's section 272 regulations do, the *SBC/Ameritech Merger Order* requires only that SBC provide OI&M "pursuant to a written agreement" and on a "nondiscriminatory basis."[49] Further, the Commission excused from the nondiscrimination requirement OI&M activities "performed by an incumbent LEC in the normal course of providing unbundled elements, services or interconnection."[50] There is simply no way to reconcile SBC's sweeping (and

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[46] *ASI Forbearance Order* ¶ 8 (discussing SBC's evidence that purported to show that since SBC had been abiding by the separate affiliate conditions of the *SBC/Ameritech Merger Order*, "ASI provided affiliated and unaffiliated ISPs with the same level of provisioning, installation, maintenance, and repair service").

[47] *See id.* ¶¶ 27- 29.

[48] *SBC/Ameritech Merger Order* ¶ 365.

[49] *Id.* ¶ 365 & n.678.

[50] *Id.* n.678.

unsupported) claims about the costs of duplicative personnel and delayed provisioning of advanced services with the modest – but critically important – nondiscrimination provision actually imposed by the merger conditions.

III. SBC'S "FACT" DECLARATION IS LARGELY IRRELEVANT AND, IN ALL EVENTS, ENTITLED TO NO WEIGHT.

The gaping deficiencies in SBC's arguments are not overcome by the "fact" declaration of Mr. Richard Deitz that SBC appended to its petition. Even if Mr. Dietz had demonstrated with hard evidence that the section 272 OI&M safeguards are "costly," that is irrelevant to the central legal standards for forbearance,[51] which require an assessment whether enforcement of the OI&M rules is necessary to prevent "unjust[] or unreasonably discriminatory" practices by SBC,[52] and whether these regulations are necessary "for the protection of consumers."[53] Likewise, with respect to the OI&M regulations imposed in the *SBC/Ameritech Merger Order*, Mr. Dietz is unable to provide any evidence as to how SBC's requested waiver "affirmatively and identifiably promotes the underlying purpose of the condition" – *i.e.*, how a waiver would "ensure that *competing providers* of advanced services receive effective, nondiscriminatory access to the facilities and services of the merged firm's incumbent LECs that are necessary to provide advanced services" and that are intended to "lower[] the costs and risks of entry."[54] Nor could he, as SBC is proposing to eliminate wholesale regulations that protect competition (and thus consumers) without replacing them with any comparable protections.

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[51] This, of course, assumes that the Commission even has legal authority to forbear from applying section 272, as incorporated into section 271(d)(3)(B). As explained above, it does not.

[52] 47 U.S.C. § 160(a)(1).

[53] *Id.* § 160(a)(2).

[54] *Bell Atlantic/GTE Advances Services Waiver Order*, 16 FCC. Rcd. 16915, ¶ 7 (CCB 2001) (discussing cognate merger provisions imposed on Bell Atlantic and GTE).

In all events, Mr. Dietz's declaration cannot be taken seriously. Mr. Dietz fails to come to grips with the fact that the *SBC/Ameritech Merger Order* does not ban the sharing of OI&M between SBC's incumbent LEC operations and ASI. All of Mr. Dietz's concrete "examples" of the ways in which OI&M rules have caused undue "delay[s]" pertain to ASI, which, as explained above, is *already permitted* to share services with SBC's incumbent LEC operations (pursuant to non-discrimination rules that SBC itself proposed).[55] Contrary to Mr. Dietz's suggestions, SBC can establish a central customer contact for ASI customers, SBC incumbent LEC personnel can connect and test the network components required to provide a customer's basic and advanced services, and SBC incumbent LEC personnel can repair troubles reported by ASI customers.[56] All that is required is that SBC make these same services available to other competitive carriers on non-discriminatory terms and conditions. To the extent that the costs Mr. Dietz is documenting are the result of an affirmative decision by SBC to avoid the nondiscrimination provisions of the merger conditions by not allowing the incumbent LEC personnel to perform OI&M services on behalf of ASI, that, of course, is no basis for eliminating the merger conditions.

Of course, the strongest evidence that the merger condition OI&M rules do not impose the onerous costs claimed by SBC is the fact that SBC has the ability to eliminate these costs entirely tomorrow. SBC is under *no* affirmative obligation to maintain a separate advanced services affiliate; that obligation was subject to sunset triggers that have now been met.[57] Thus, SBC is free *at any time* fully to reintegrate its advanced services operations with its incumbent

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[55] *See* SBC Pet., Dietz Dec. ¶¶ 6-9.

[56] *SBC/Ameritech Merger Order*, Merger Condition I.3.c, I.3.f-l.

[57] *Id.*, Merger Condition I.12.

LEC operations. That it has not done so belies its claims that these rules impose over $77 million of unnecessary costs each year. To be sure, as explained above, if SBC were to integrate ASI into its incumbent LEC operations, SBC's advanced services would then be subject to dominant carrier tariffing and related requirements. But that is a necessary consequence of the fact that SBC would be dominant and have the ability to abuse that dominance in the absence of existing safeguards.

With respect to the application of the section 272 OI&M rules to SBCLD, Mr. Dietz provides nothing of substance. For example, Mr. Dietz complains that SBC recently lost a bid for large customer because its costs were higher than its competitors.[58] But Mr. Dietz stops short of claiming that all, or even the majority, of SBC's higher costs were the result of the OI&M rules.[59] All Mr. Dietz can claim is that absent those rules SBC's overall costs of providing service would be "lower" by some undefined amount and that this "might" have enabled SBC to win the bid.[60]

More broadly, whatever the costs and inefficiencies the OI&M requirement imposes on BOCs and their section 272 affiliates, they are *no different* than the costs and inefficiencies faced by the BOCs' competitors, and they are outweighed by the potential anticompetitive effects that would result if the OI&M requirements were eliminated prematurely. Competitors, which remain dependent on the BOC's network, also cannot respond as a single team to provide end-to-end service. Any added burdens of the OI&M requirement, therefore, do not and cannot place

[58] SBC Pet., Dietz Dec. ¶ 10.

[59] *Id.*

[60] *Id. Cf. AT&T Corp. v. Business Telecom, Inc.* 16 FCC Rcd. 12312, ¶ 49 (2001) (an expert which testifies merely that a company's costs "may" be higher does not establish "any record basis" allowing the Commission to conclude that the costs are in fact higher "at all.").

BOCs and their section 272 affiliates at any competitive disadvantage vis-à-vis their competitors; instead, as the Commission found in the *SBC/Ameritech Order*, it places them on equal footing.

In fact, contrary to SBC's claims that the OI&M restriction hobbles its operations, in the few short years since it has been granted long distance authority in its Southwestern territories, SBC has gained customers at an unprecedented rate. According to SBC's Chief Executive Officer, SBC has achieved "near 50 percent" penetration of the consumer long distance market in states other than California where it has offered long distance service prior to April 2003.[61] As to California, Mr. Whitacre claimed that SBC has achieved "a retail penetration rate of 13 percent on the consumer side, 10 percent overall" in "less than four months" since SBC commenced long distance service.[62] SBC never explains how it is economically possible for its market share to be increasing at unprecedented levels – in a market it characterizes as "highly competitive" – if its costs are in fact substantially inflated by the OI&M restriction.

Finally, while Mr. Dietz claims to have commissioned an internal study to quantify the "costs" of the OI&M rules, Mr. Dietz provides no basis whatsoever for testing the veracity of his numbers. Mr. Dietz provides no explanation of the methodology that his subordinates used. Mr. Dietz provides no clue whether he studied any potential offsetting costs of "re-integration." Mr. Dietz provides no analysis whether the OI&M costs that he identified could be lowered by more efficient practices by SBC. Mr. Dietz provides none of the workpapers generated by the employees that supposedly undertook the study. And other than the barest summaries, Mr. Dietz provides no explanation for each category as to how the changes would, in fact, lower costs. In

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[61] *See* Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

[62] *Id*.

short, Mr. Dietz provides only *ipse dixit*, which falls well short of SBC's affirmative obligation to prove its entitlement to forbearance under section 10 or a waiver of the *SBC/Ameritech Merger Order*.[63]

CONCLUSION

For the reasons stated above, SBC's petition should be denied.

Respectfully submitted,

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July 1, 2003

[63] For these reasons, the Commission should order SBC to produce the workpapers and other documentation underlying Mr. Dietz's "study." Until the record contains such evidence that would permit the Commission and commenters to verify Mr. Ditez's claims, his testimony about the costs of the OI&M prohibition is entitled to no weight.

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of July, 2003, I caused true and correct copies of the foregoing Comments of AT&T Corp. to be served on all parties by the noted methods to their addresses listed on the attached service list.

Dated: July 1st, 2003
Washington, D.C.

/s/Patricia A. Bunyasi
Patricia A. Bunyasi

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Exhibit C

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of BellSouth for Forbearance From the Prohibition of Sharing Operating, Installation and Maintenance Functions Under Sections 53.203(a)(2)-(3) of the Commission's Rules	)	CC Docket No. 96-149

COMMENTS OF AT&T CORP.
IN OPPOSITION TO BELLSOUTH'S PETITION FOR FORBEARANCE

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Pursuant to the Commission's Notice (July 16, 2003), AT&T Corp. ("AT&T") hereby submits its opposition to BellSouth's Petition for Forbearance ("Pet."). BellSouth seeks forbearance from the "crucial[ly] importan[t]"[1] provisions of section 272 that prohibit BellSouth from having incumbent local exchange carrier ("LEC") subsidiaries perform "operating, installation and maintenance" ("OI&M") services on behalf of its long distance subsidiary.

BellSouth's seven-page boilerplate petition presents not a single new argument that has not already been advanced by other BOCs' petitions for forbearance from the OI&M requirements. As described below and in AT&T's previous pleadings in this proceeding, the prohibition against sharing of OI&M services remains critically necessary to help prevent cost misallocation and discrimination – and will continue to provide significant and unique benefits that will outweigh any costs of compliance so long as BellSouth and the BOCs retain their market power over local bottleneck facilities. And even if such costs were relevant, BellSouth's petition also fails to provide even a shred of factual support for its claims that compliance with the OI&M prohibition "imposes unnecessary costs and inefficiencies on its operations." Pet. at 2. Contrary to BellSouth's claim (*id.*) that the Commission did not have a proper record before it when it promulgated the prohibition against sharing of OI&M, the rule is based expressly on section 272's "operate independently" requirement and is fully consistent with the prior cost-benefit analyses conducted by the Commission over the past 20 years.[2] Further, BellSouth's petition for forbearance is particularly inappropriate in light of the Commission's recent enforcement actions against BellSouth for violations of section 272's nondiscrimination and separation requirements.

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[1] *Texas 271 Order*, 15 FCC Rcd. 18354, ¶ 395 (2000).

[2] *See Ex Parte* Letter from C. Frederick Beckner III, counsel to AT&T, to Marlene Dortch, FCC, at 5-8 (CC Docket No. 96-149, July 9, 2003).

INTRODUCTION AND SUMMARY

In the *Non-Accounting Safeguards Order*, the Commission concluded "that allowing the same personnel to perform the operating, installation, and maintenance services associated with a BOC's network and the facilities that a section 272 affiliate owns or leases from a provider other than the BOC would create the opportunity for such substantial integration of operating functions as to preclude independent operation, in violation of section 272(b)(1)."[3] In creating this prohibition, the Commission explicitly relied on a principle established when the BOCs were first created – that allowing a BOC to provide network-related services on behalf of an affiliate "would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation."[4] Thus, the Commission concluded that the OI&M prohibition was vital to fulfilling section 272's central purpose of "prohibit[ing] anticompetitive discrimination and cost-shifting."[5]

Despite the Commission's repeated recognition of the need for and benefit of OI&M "separation," the BOCs sought reconsideration of the Commission's imposition of the OI&M safeguards in the *Non-Accounting Safeguards Order*, claiming that the Commission's interpretation of section 272 was not mandated by the statutory language, and that it was unnecessary to protect against improper cost allocation or discrimination. The Commission again rejected these claims, reasserting its determination that section 272 precludes shared OI&M services, and recognizing that any other ruling would "create a loophole around the

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[3] *Non-Accounting Safeguards Order*, 11 FCC Rcd. 21905, ¶ 163 (1996).

[4] *Id.* (citing *BOC Separations Order*, 95 F.C.C.2d 1117 (1983)) (emphasis added).

[5] *Id.* ¶ 9.

separate affiliate requirement" and would provide for such "substantial integration of these essential functions . . . that independent operation would be precluded."[6]

Developments since the *Non-Accounting Safeguards Order* have only confirmed the need for and utility of strong OI&M rules. For example, in merger proceedings involving large LECs, the Commission found that LECs continue to retain "incentive[s] to discriminate" against independent long distance carriers and that these incentives are "particularly acute with regards to advanced or customized access services for which detection of discrimination is most difficult."[7] Moreover, the Commission in those proceedings rejected the claim that regulators have developed proper tools to detect and prevent discrimination by a BOC and its subsidiaries: "With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination."[8]

BellSouth's forbearance petition contains no evidence of changed circumstances that could justify repealing the OI&M services restriction required by section 272. Of course, as AT&T recently explained in response to a Verizon white paper, that claim is barred as a legal matter by section 10(d) of the Communications Act, which explicitly precludes the Commission from forbearing from the requirements of section 271 until section 271 is "fully implemented," a showing that BellSouth does not even attempt.[9] Section 271(d)(3)(B) expressly provides that the

[6] *Non-Accounting Safeguards Third Order On Reconsideration*, 14 FCC Rcd. 16299, ¶ 20 (1999).

[7] *SBC/Ameritech Merger Order* ¶ 196; *see also id.* ¶¶ 212-35.

[8] *Id.* ¶ 220.

[9] *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149 July 9, 2003).

Commission may grant a BOC long distance authority only if the requested authorization "will be carried out in accordance with the requirements of section 272." 47 U.S.C. § 271(d)(3)(B). BellSouth's Petition would require the Commission to forbear from applying section 271(d)(3)(B), which it is forbidden to do by section 10(d).

In all events, long distance carriers and advanced services providers remain dependent upon BellSouth and the other BOCs for last mile facilities necessary to access their customers. BellSouth and the other BOCs therefore retain substantial local market power and the ability and incentive to leverage this market power to undermine competition in long distance and advanced services markets. Hence, section 272's "operate independently" rules in general, and the OI&M rules in particular, remain necessary to prevent BellSouth from using its control of bottleneck facilities to raise rivals' costs and prevent long distance and advanced services competition on the merits.

If there were any error in the Commission's original balancing of costs and benefits in this area, it is that is that the Commission *underestimated* the competitive harm arising from shared BOC/272 services, and allowed *too much* sharing of other services. Although the Commission prohibited the sharing of OI&M services, it did not restrict the sharing of many other services necessary to operate BellSouth's long distance affiliate. As a result, in many areas BellSouth has the unique advantage of being able to provide service on an "integrated" basis. On this record, there can be no serious claim that the joint OI&M prohibition is an unwarranted restriction.

ARGUMENT

BellSouth merely reproduces arguments advanced by Verizon and SBC in their petitions for forbearance from the section 272 OI&M rules. As AT&T explained in its responses to Verizon and SBC,[10] the complete answer to BellSouth's argument is that BellSouth and the other Bells continue to exercise considerable local market power and can use that power to discriminate against their long distance rivals. Given that the Bells' forbearance petitions would eliminate altogether the OI&M safeguards – and thereby materially weaken the effectiveness of section 272 as a safeguard for preventing the Bells from acting on their incentives to raise rivals' costs – there can be no basis for a finding, as required by section 10 of the Communications Act (47 U.S.C. § 160(a)), that the requested forbearance is consistent with the public interest and the interests of consumers. This is not just the view of AT&T, but the position of every state regulatory commission that has filed comments on this issue.[11]

Rather than attempt to show with hard evidence that it has lost market power, BellSouth rehashes the same arguments it and the other BOCs presented – and the Commission rejected – in challenging the OI&M rule at multiple stages of the *Non-Accounting Safeguards* proceedings.[12] For example, BellSouth asserts that other non-structural section 272 requirements

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[10] *See generally* AT&T's Opposition to Verizon Petition for Forbearance (CC Docket No. 96-149, Sep. 9, 2002); *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, Nov. 15, 2002); Comments of AT&T Corp. on SBC Petition (CC Docket 96-149, July 1, 2003); *Ex Parte* Letter from C. Frederick Beckner III, counsel to AT&T, to Marlene Dortch, FCC, at 5-8 (CC Docket No. 96-149, July 9, 2003); *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149 July 9, 2003).

[11] *See, e.g.*, Washington UTC 272 Sunset Comments (WC Docket No. 02-112, Aug 5, 2002); Missouri PSC 272 Sunset Comments (WC Docket No. 02-112, Aug. 5, 2002); Pennsylvania PUC 272 Sunset Comments (WC Docket No. 02-112, July 22, 2002); Texas PUC 272 Sunset Comments at 3 (WC Docket No. 02-112, July 25, 2002).

[12] *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Second Order On Reconsideration*, 12 FCC Rcd. 8653, ¶ 12 (1997); *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20.

make the OI&M restriction unnecessary.[13] The Commission has already responded to each of these contentions, and has provided more than adequate support for its interpretation of section 272(b)(1) as precluding shared OI&M functions. Applying traditional rules of statutory construction,[14] the Commission stressed that shared OI&M services would "inevitably" lead to a level of BOC/affiliate integration that was precluded by the operate independently requirement of section 272(b)(1).[15] For example, such shared services "would inevitably afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors."[16] The Commission separately recognized that allowing such shared OI&M services would create "substantial opportunities for improper cost allocation."[17]

Like the other BOCs, BellSouth dismisses these conclusions, asserting that (despite the Commission's repeated contrary findings) there is nothing unique about OI&M network services that justifies treatment different than other administrative services where the Commission has approve sharing, and that BellSouth does not and cannot use OI&M service to discriminate against competitors.[18] BellSouth, however, provides no support for its blanket charge that the

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[13] BellSouth Pet. at 3-4. Even though BellSouth claims here that the Commission's accounting safeguards and affiliate transaction rules "have proven to be effective" and would be adequate to prevent cost misallocation arising from shared OI&M, *id.*, in other proceedings before the Commission, BellSouth has expressly called for the Commission to abolish entirely its cost allocation rules, which BellSouth called a "relic of the past." *E.g.*, Letter from Mary L. Henze, BellSouth, to Marlene Dortch, FCC, CC Docket No. 02-33 (June 19, 2003).

[14] *See, e.g. Non-Accounting Safeguards Order* ¶ 156 (recognizing that this interpretation of operate-independently requirement "is based on the principle of statutory construction that a statute should be construed so as to give effect to each of its provisions"); *id.* (reasoning that the "structural differences in the organization of [sections 272(b) and 274(b)] suggest that the term 'operate independently' in section 272(b)(1) should not be interpreted to impose the same obligations . . . as section 274(b)").

[15] *Non-Accounting Safeguards Order* ¶ 163.

[16] *Id.*

[17] *Id.*

[18] BellSouth Pet. at 3-4, 6.

Commission was mistaken when it deemed the BOCs' networks, and services directly concerning those networks, fundamentally different than other BOC services. These network facilities are the basis for the BOCs' market power, and are virtually always required inputs for the BOCs' competitors. The Commission has long recognized that network-specific functions are especially susceptible to BOC discrimination with potentially devastating consequences for competitors dependent on these facilities.[19] The Commission likewise long ago recognized the unique opportunities for cost misallocation concerning network services and related expenses.[20] Until BellSouth's control of bottleneck local facilities dissipates, therefore, the OI&M restriction (like the related bar on joint ownership of network facilities) is a necessary corollary to any requirement that a BOC and its affiliate "operate independently."

Nor are the other requirements of section 272 (such as section 272(e)'s nondiscrimination requirement) or related "performance measures" adequate substitutes for the type of structural separation imposed by the OI&M and other "operate independently" requirements under section 272(b)(1). Enforcement of nonstructural safeguards requires both detection and quick and effective enforcement. Yet the sharing of OI&M that BellSouth seeks would, as the Commission has concluded since 1983, make detection of misconduct far more difficult. And even if it were discovered, by the time the complaint process had run its course, the damage to competitors and competition would be done. Indeed, BellSouth has already shown that it will violate section 272's requirements – and choose to incur any enforcement fines merely as a cost of entering the long distance market. The Commission recently brought an enforcement action against BellSouth for apparent violations of section 272, including discrimination against customers of

[19] *See, e.g. Non-Accounting Safeguards Order* ¶¶ 158-166.

[20] *See BOC Separations Order* ¶ 70.

competing local exchange carriers.[21] Further, this Commission has elsewhere stressed the need for structural safeguards, because BOCs can discriminate in myriad subtle forms, and it is "impossible for the Commission to foresee every possible type of discrimination."[22]

Further, and as AT&T has previously explained in response to Verizon and SBC's claims, the BOCs face no competitive disadvantage by virtue of the OI&M prohibition. Thus, whatever the costs and inefficiencies the OI&M requirement imposes on BOCs and their section 272 affiliates, they are *no different* than the costs and inefficiencies faced by the BOCs' competitors, and they are outweighed by the potential anticompetitive effects that would result if the OI&M requirements were eliminated prematurely.[23] Competitors remain dependent on the BOC's network and cannot respond as a single team to provide end-to-end service. Any added burdens of the OI&M requirement, therefore, do not and cannot place BOCs and their section 272 affiliates at any competitive disadvantage vis-à-vis their competitors; instead, as the Commission found in the *SBC/Ameritech Order*, it places them on equal footing.

Finally, there is no basis for BellSouth's claims that the OI&M prohibition is particularly inappropriate to apply to broadband services. Pet. at 3, 7. To the contrary, the Commission has

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[21] *See In the Matter of BellSouth Corp.*, File Nos. EB-02-IH-0683, *et al.* (July 17, 2003).

[22] *SBC/Ameritech Merger Order* ¶ 206. Performance measures to gauge BellSouth's performance are inadequate and not a substitute for the OI&M prohibition. Although no biennial audits of BellSouth's section 272 operations have been released, the existing audits have been patently inadequate in providing detailed performance measures (and yet have still revealed BOC discrimination in favor of its affiliates). Further, with regard to "special access" performance standards, there are none. The Commission has yet to act despite having sought comments almost two years ago as to the type of measures and penalties it should adopt.

[23] Even compared to the material provided by other BOCs, BellSouth's support for its claims that the OI&M prohibition is costly is conclusory and wholly unverifiable. *See* Pet. at 2. In all events, given the significant pro-competitive benefits that arise from the OI&M restriction so long as the Bells retain market power over key inputs into long distance and advanced services markets, the costs of compliance are not relevant. Because there is a "strong connection" between the OI&M safeguards and the protection of competition, they are "necessary" within the meaning of Section 10, and forbearance may not be granted. *See Ex Parte* Letter from C.

(continued . . .)

determined that structural safeguards like the prohibition on shared OI&M are even more necessary for broadband and other advanced services. Thus, when the Commission decided, in merger proceedings involving the Bells, that it was appropriate to require the Bells to provide advanced services through a separate affiliate, the Commission found that the risks that the BOCs will discriminate against their rivals were the greatest for new and advanced services, because there is little or no track record by which to gauge the BOC's performance.[24] Because the Bells control bottleneck facilities needed by rival broadband providers, they retain in that market – as in the long distance and other narrowband markets – strong incentives and increased ability to misallocate costs and to discriminate against those rivals. The ban on shared OI&M, as applied to broadband services, is a critical safeguard to help detect and prevent such misconduct and harm to the retail broadband market.

(. . . continued)
Frederick Beckner III, counsel to AT&T, to Marlene Dortch, FCC, at 3 (CC Docket No. 96-149, July 9, 2003).

[24] *SBC-Ameritech Merger Order* ¶ 220 ("With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination"); *id.* ¶ 196 (BOC discrimination is "particularly acute with regards to advanced or customized access services for which detection of discrimination is most difficult").

CONCLUSION

For the reasons stated above, BellSouth's petition should be denied.

Respectfully submitted,

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August 6, 2003

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of August, 2003, I caused true and correct copies of the foregoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: Aug. 6th, 2003
Washington, D.C.

/s/ Patricia A. Bunyasi
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Exhibit D

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Petition of Qwest Services Corp. for Forbearance From the Prohibition of Sharing Operating, Installation and Maintenance Functions Under Sections 53.203(a)(2)-(3) of the Commission's Rules	CC Docket No. 96-149

OPPOSITION OF AT&T CORP.
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October 29, 2003

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Pursuant to the Commission's Notice,[1] AT&T Corp. ("AT&T") hereby submits its opposition to Qwest Services Corporation's ("Qwest") Petition for Forbearance ("Pet."). Qwest seeks forbearance from the "crucial[ly] importan[t]"[2] provisions of section 272 that prohibit Qwest from having Bell Operating Company ("BOC") subsidiaries perform "operating, installation and maintenance" ("OI&M") services on behalf of its long distance subsidiary.

INTRODUCTION AND SUMMARY

Qwest's "me-too" petition presents no new arguments that have not already been advanced by the other BOCs' petitions for forbearance from the OI&M requirements. As described in AT&T's previous pleadings in this proceeding, forbearance is unlawful and, in all events, is not remotely justified by the record put forward by any of the BOCs.[3] In particular, AT&T has demonstrated that the prohibition against sharing of OI&M services remains critically necessary to help prevent cost misallocation and discrimination – and will continue to provide significant and unique benefits so long as Qwest and the BOCs retain their market power over local bottleneck facilities. AT&T has further explained that the BOCs have failed to provide any convincing support for their claims that compliance with the OI&M prohibition impose unnecessary and substantial costs.

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[1] Public Notice, DA 03-3113 (October 8, 2003).

[2] *Texas 271 Order*, 15 FCC Rcd. 18354, ¶ 395 (2000).

[3] *See generally* AT&T's Opposition to Verizon Petition for Forbearance (CC Docket No. 96-149, Sep. 9, 2002); *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, Nov. 15, 2002); Comments of AT&T Corp. on SBC Petition (CC Docket 96-149, July 1, 2003); *Ex Parte* Letter from C. Frederick Beckner III, AT&T, to Marlene Dortch, FCC, at 5-8 (CC Docket No. 96-149, July 9, 2003); *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149 July 9, 2003) ("*AT&T July 9 Cost Ex Parte*"); AT&T's Opposition to BellSouth Petition for Forbearance (CC Docket No. 96-149, Aug. 6, 2003); *Ex Parte* Letter from Frank Simone, AT&T, To Marlene Dortch, FCC, (CC Docket No. 96-149, Oct. 1, 2003); *Ex Parte* Letter from C. Frederick Beckner III, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, Oct. 21, 2003).

In this regard, Qwest's petition falls farthest from the mark, because Qwest flatly admits that it currently "incurs very few OI&M costs." Pet. at 7. Thus, the Commission is here presented with a record where it is being asked to forbear from applying a concededly costless but vitally important and pro-competitive regulation. There is thus no dispute here that the benefits of the OI&M ban far outweigh the (non-existent) costs. And the Commission cannot forbear from these critically important safeguards based on speculation that Qwest may soon begin to incur "future costs" (Pet. at 14) – particularly where no BOC has ever come forward with credible evidence that compliance with OI&M regulations is costly.

Qwest's further claim that its customers are hindered in obtaining "end-to-end" customer service because of the OI&M restriction is simply incorrect and inconsistent with marketplace realities. If, as Qwest claims, the OI&M restriction caused BOC customers to receive less efficient service, then Qwest and the other BOCs would not be winning new customers at the rates that they have proclaimed. In fact, the ban on joint provision of OI&M does not disadvantage BOCs, but rather places them on an equal playing field with their competitors. Neither Qwest nor any other BOC has demonstrated that long distance competitors are better able to provide end-to-end customer service than BOC section 272 affiliates – because Qwest and the other BOCs maintain a firm grip on critical inputs like special access, competitors (and their customers) also must endure the inefficiencies that result from relying on the BOCs.

The Commission has determined, in proceedings since 1983 when the BOCs were first created, that allowing a BOC to provide network-related services on behalf of an affiliate "would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation."[4] Despite the Commission's repeated recognition of the need for and benefit of OI&M "separation," the BOCs have repeatedly sought to eliminate this pro-competitive requirement. Year-after-year, the Commission has consistently rebuffed those efforts, reasserting its determination that section 272 precludes shared OI&M services, and recognizing that any other ruling would "create a loophole around the separate affiliate requirement" and would provide for such "substantial integration of these essential functions . . . that independent operation would be precluded."[5] At the end of the day, Qwest and the other BOCs provide no new arguments why this longstanding conclusion should be revisited. Because the OI&M prohibition is just as vital today in fulfilling section 272's central purpose of "prohibit[ing] anticompetitive discrimination and cost-shifting," it must be retained.[6]

I. QWEST'S PETITION FOR FORBEARANCE IS PROSCRIBED BY SECTION 10(d).

Qwest's claim (Pet. at 9-13) that Section 10 provides the Commission with authority to forbear from applying its OI&M rules (47 C.F.R. §§ 53.203(a)(2)-(3)) flatly ignores the text of that section. As AT&T has previously explained in responding to a Verizon "white paper," section 10(d) explicitly limits the Commission from exercising forbearance authority in the manner requested by Qwest.[7] Because AT&T's *ex parte* responses are already in the record in

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[4] First Report and Order and FNPRM, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272,* 11 FCC Rcd. 21905, ¶ 163 (1996) ("*Non-Accounting Safeguards Order*") (relying on *BOC Separations Order*, 95 F.C.C.2d 1117 (1983)) (emphasis added).

[5] Third Order On Reconsideration, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272*, 14 FCC Rcd. 16299, ¶ 20 (1999) ("*Non-Accounting Safeguards Third Order On Reconsideration*"); *see infra* note 21.

[6] *Non-Accounting Safeguards Order* ¶ 9.

[7] *E.g.*, *Ex Parte* Letter from C. Frederick Beckner III, AT&T, to Marlene Dortch, FCC, at 5-8 (CC Docket No. 96-149, July 9, 2003); *Ex Parte* Letter from Frank Simone, AT&T, to Marlene Dortch, FCC, (CC Docket No. 96-149, Oct. 20, 2003); *Ex Parte* Letter from C. Frederick Beckner III, AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, Oct. 21, 2003).

this proceeding, a lengthy response to Qwest's arguments is unnecessary. To put it simply, Section 10(d) of the Communications Act, entitled "Limitation," provides:

> Except as provided in section 251 of this title, *the Commission may not forbear from applying the requirements of section 251(c) or 271 of this title* under subsection (a) of this section until it determines that those requirements have been fully implemented.

47 U.S.C. § 160(d) (emphasis added). Section 271(d)(3), in turn, explicitly requires that a BOC provide long distance service in accordance with the requirements of section 272. Specifically, the Commission "*shall not approve* the [long distance] authorization requested . . . unless it finds that . . . (B) the requested authorization will be carried out *in accordance with the requirements of section 272* of this title." 47 U.S.C. § 271(d)(3) (emphasis added). The plain language of section 271(d)(3), accordingly, incorporates "the requirements of section 272" into section 271, and the equally plain text of section 10(d) forbids the Commission to "forbear from applying the requirements of . . . 271" until that statute is "fully implemented" – a demanding standard that Qwest does not even claim to satisfy. The combination of these provisions leads inexorably to the conclusion that the Commission is forbidden to forbear from applying any of the "requirements" of section 272 that have been incorporated by reference into section 271.

Further, it is clear that the "requirements" referred to in section 10(d) include both the provisions of the Act *and* the Commission's implementing regulations, including the OI&M safeguard. Other sections of the Communications Act make clear that Congress used the term "requirement" to include the Commission's implementing regulations. For example, section 252(e)(2)(B) forbids a state commission from approving an interconnection agreement "if it finds that the agreement does not meet the requirements of section 251 of this title, *including the regulations prescribed by the Commission pursuant to section 251 of this title*, or the standards set forth in subsection (d) of this section." 47 U.S.C. § 252(e)(2)(B) (emphasis added).[8] Thus, a "requirement" is clearly, *inter alia*, a "regulation" for which the Commission is barred from granting forbearance until it makes an affirmative finding that section 251(c) and 271 have been fully implemented.[9]

Qwest claims that the "single statutory reference" to section 272 contained in section 271 cannot "expand" section 10(d)'s limitation on forbearance authority. Pet. at 10. But that limitation plainly applies to the "requirements" of section 271, and the fact that section 272 requirements are incorporated by reference into section 271 does not mean that they are not, as Qwest would have it, "requirements" of section 271. Indeed, in Qwest's section 271 applications, it pledged to the Commission that it would comply with the section 272 obligations, *including* the OI&M restrictions. And, crediting Qwest's claims, the Commission made express findings that Qwest would comply with section 272, findings that are a necessary predicate to granting a section 271 application.[10] Neither Qwest nor the Commission would have engaged in

[8] Likewise in section 251(b)(2), local exchange carriers are obligated to provide "number portability in accordance with the requirements prescribed by the Commission." 47 U.S.C. § 251(b)(2).

[9] Even if there were ambiguity on this point, it has been resolved against Qwest. The Commission has already recognized that the term "requirement" in section 10(d) applies to "statutory provisions" and to "implementing regulations." Notice of Inquiry, *1998 Biennial Review*, 13 FCC Rcd. 21879, ¶ 32 (1998). The Commission has, therefore, made clear that the OI&M rules implementing section 272 constitute "requirements" of section 272, and thus of section 271(d)(3)(B).

[10] *E.g.*, *Qwest 9-State 271 Order*, 17 FCC Rcd. 26303, ¶¶ 387-88 (2002); *Qwest Minnesota Order*, 18 FCC Rcd. 13323, ¶¶ 62-65 (2003) (citing Qwest Application at 105 (pledging that "QLDC and QCC have not engaged and will not engage in OI&M")); *Qwest 3-State 271 Order*, 18 FCC Rcd. 7325, ¶¶ 112-115 (2003) & Qwest Application at 157 (same).

this exercise if the OI&M prohibition were not a "requirement" of section 271.[11] The section 272 requirements "expand" the showing required for section 271 authorization and, by the same token, limit the Commission's authority to forbear from them just as though they were set forth directly into the text of section 271.

Qwest also contends that the lone authority addressing this issue – a decision by the Common Carrier Bureau rejecting the same reading of the Act that Qwest advanced here and finding that "prior to their full implementation, *we lack authority to forbear from application of the requirements of section 272* to any service for which the BOC must obtain prior authorization under section 271(d)(3)"[12] – need not be followed. *See* Pet. at 11. According to Qwest, the Commission's Staff has not been delegated authority to act on questions that present novel questions of law and that cannot be resolved by "outstanding precedents or guidelines." Pet. at 11 n.28 (quoting 47 C.F.R. § 0.291(a)(2)).[13] But the Bureau resolved the issue before it by looking at the most appropriate "guideline" – the text of the Act – and it therefore properly determined that section 10(d) prohibited forbearance from the requirements of section 272 prior to full implementation of section 251(c) and 271. In any event, and regardless of the Bureau's authority to resolve the issue or otherwise bind the full Commission, the Commission, too, is

[11] By the same token, if Qwest suddenly refused to comply with the OI&M restriction, it would no longer be complying with section 272, which would, as the Commission has recognized, justify a finding under section 271(d)(6) that Qwest is violating a condition of its section 271 authorization and that such authority should be suspended or revoked.

[12] *Section 272 Forbearance Order*, 13 FCC Rcd. 2627, ¶ 22 (C.C.B. 1998) (emphasis added); *see also id.* ¶ 23 (sections 10(d) and 271(d)(3) "preclude[] [the Commission's] forbearance for a designated period from section 272 requirements with regard to any service for which a BOC must obtain prior authorization pursuant to section 271(d)(3)").

[13] Of course, if the Bureau literally had no authority to "act on [the BOCs' forbearance] requests" (*id.*), then the Bureau's orders authorizing them to provide non local-directory service would be voided.

undoubtedly bound by the plain terms of the Act.[14] It therefore cannot forbear from the OI&M requirement unless it can explain what its own Staff could not: that section 272 requirements are not also requirements of section 271, even though Congress expressly required the Commission to find that a BOC complied with the requirements of section 272 as a necessary precondition to section 271 authorization.[15] Absent such an explanation, the Commission's authority to forbear from the OI&M rules is squarely limited by section 10(d).

Though it would have the Commission ignore the Bureau's decision and its dispositive analysis, Qwest relies heavily on the Commission's cases regarding forbearance in connection with "incidental interLATA services" provided under section 271(g)(4). Like Verizon, Qwest argues as follows: section 271(g)(4) authorizes BOCs to provide "incidental interLATA services"; section 272(a)(2)(B)(i) requires a BOC to provide certain "incidental interLATA services" through a separate affiliate; the Commission has exercised its forbearance authority in connection with the latter provision; and therefore, section 10(d)'s bar on forbearance in connection with section 271 does not extend to section 272. *See* Pet. at 12.

The central, erroneous premise of this argument is that section 271(d)(3) incorporates all of the requirements of section 272 into 271. It does not. Section 271(d)(3) incorporates (and thus shields from forbearance) only those section 272 requirements that relate to the BOCs' provision of interLATA services that require Commission "authorization." Put differently, section 271(d)(3) incorporates only the section 272 requirements that must be satisfied as a

[14] *See GTE Serv. Corp.* v. *FCC*, 205 F.3d 416, 424 (D.C. Cir. 2000) ("the Commission must operate within the limits of 'the ordinary and fair meaning of [the Communications Act's] terms'") (quoting *AT&T* v. *Iowa Utils. Bd.*, 525 U.S. 366, 390 (1999)).

[15] Further, the courts of appeals have found that the Commission *is* obligated to reconcile its precedents with Staff rulings. *E.g.*, *Northampton Media Ass'n* v. *FCC*, 941 F.2d 1214, 1216 (D.C. Cir. 1991).

prerequisite to long distance authorization under section 271(d). The BOCs are not required to obtain Commission authorization to provide "incidental interLATA services," and thus section 271(d)(3) does not incorporate section 272(a)(2)(B)(i) (the "incidental interLATA services" provision) by reference and forbid forbearance.[16] The authority cited by Qwest – which permitted forbearance of the separate affiliate requirement in connection with "incidental interLATA services" under section 271(g) – is, consequently, utterly irrelevant to the scope of the exception to the Commission's forbearance authority established in section 10(d).

Qwest also claims – by citing to nothing other than a Verizon *ex parte* – that the Commission has more authority to forbear from its own regulations than from statutory provisions. *See* Pet. at 12-13 & n.32. But that finds no support either in the text of section 10(d), which applies to "requirements" of section 271 and thus equally to the Act or implementing regulations, or generally in administrative law, which holds that agencies are bound by their own rules in like manner to their organic Act.[17] Qwest's claim that the Commission could revisit its original interpretation of section 272 in the OI&M rules reveals its actual and inappropriate agenda: in the guise of seeking forbearance that is forbidden to it by statute, Qwest is in fact attempting to obtain the elimination of a rule, but by avoiding the trouble of filing a petition for

[16] The Forbearance Order recognized this precise distinction. *Section 272 Forbearance Order* ¶ 2 (Our "authority to forbear" from the application of section 272 to a BOC's provision of enhanced 911 services is "not affected by the limitation in section 10(d) of the Act on the Commission's authority to forbear from applying the requirements of section 271 prior to their full implementation. *Although section 271(d)(3) requires the Commission's prior approval of a BOC's application to provide in-region, interLATA service and the criteria for approval include compliance with section 272, prior Commission approval pursuant to section 271(d)(3) is not required, where, as here, the BOCs provide services that are either previously authorized within the meaning of section 271(f) of the Communications Act or incidental interLATA services as defined by section 271(g) of that Act*") (emphasis added).

[17] *E.g.*, *United States* v. *Shaughnessy*, 347 U.S. 260, 265-67 (1954); *Reuters Ltd.* v. *FCC*, 781 F.2d 946, 950-51 (D.C. Cir. 1986).

notice and comment rulemaking and in the hope of requiring the Commission to act on Qwest's "forbearance" petition within the statutory time frame in Section 10. If Qwest believes that the OI&M rules should be amended, it is free to file a petition seeking the changes that it desires. But Qwest should not be permitted to distort section 10(d) – and to eliminate the statutory safeguard against the premature lifting of the vital safeguards to competition found in the requirements of section 271 and portions of section 272 – just so that it can invoke a statutory deadline to which it is not entitled.[18]

II. QWEST'S PETITION FOR FORBEARANCE DOES NOT MEET ANY OF THE SECTION 10 FORBEARANCE CRITERIA.

Even if the Commission were not prohibited by Section 10(d) from granting Qwest's petition prior to full implementation of Sections 251(c) and 271, Qwest's petition still must be denied because Qwest does not meet any of the Section 10 criteria for forbearance. In order to grant forbearance from a Commission regulation, the Commission must find that (i) "enforcement of such regulation" is "not necessary" to ensure that a carrier's rates and practices are "just and reasonable;" (ii) that enforcement "is not necessary for the protection of consumers;" and (iii) that "forbearance . . . is consistent with the public interest." 47 U.S.C. § 160(a). Qwest's showing on each of these requirements is patently insufficient, and has already been rejected by the Commission numerous times.

A. The OI&M Rules Are Necessary To Ensure Just and Reasonable Rates

Qwest claims that the OI&M rules are not necessary to ensure reasonable rates because the Commission has already determined that BOC section 272 affiliates are non-dominant

[18] Even if this could be a proper subject for forbearance, Qwest did not caption its request for forbearance in the manner required by the Commission's rules. *See* 47 C.F.R. § 1.53. The Commission is therefore not required to rule on the request within the time frames required by Section 10.

carriers that do not have the ability to control prices. Qwest's argument is frivolous. The finding of non-dominance was specifically "predicated" on the BOCs' "full compliance" with the Section 272 safeguards and the FCC's implementing rules, including the prohibition on OI&M. *Regulatory Treatment of LEC Provision of Interexchange Services*, 12 FCC Rcd. 15756, ¶¶ 6, 104-05, 111-19, 134 (1997). Absent those safeguards, the BOC long distance affiliate would be deemed "dominant" by virtue of its affiliation with the BOC, which unquestionably does have market power and could use that power to control prices and set them above just and reasonable levels.

Specifically, the FCC has determined that, so long as a BOC controls bottleneck facilities, it will have the incentive to discriminate and to misallocate costs, so that it can "create a 'price squeeze'" by charging rival "firms prices for inputs that are higher than prices charged, or effectively charged, to the BOC's section 272 affiliate." *Non-Accounting Safeguards Order* ¶ 12. Then, "the BOC affiliate could lower its retail price to reflect its unfair cost advantage, and competing providers would be forced either to match the price reduction and absorb profit margin reductions or maintain their retail prices at existing levels and accept market share reductions." *Id.* And with respect to OI&M, the Commission has determined that allowing a BOC to provide network-related services on behalf of an affiliate "would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation." *Id.* ¶ 163 (emphasis added). Accordingly, the OI&M rules are vitally necessary to help prevent cost misallocation that would allow the Qwest BOC to act on its incentive to engage in anticompetitive price squeezes.

Qwest contends that these concerns have been eliminated by price caps and specifically by recent reforms in the interstate price cap system that, Qwest claims, have "severed the link between costs and exchange access prices." Pet. at 14. Qwest's argument is flawed, for numerous reasons.

As an initial matter, price caps are designed only to reduce the LECs' *incentive* to misallocate costs, but because (as described below) price caps alone could never entirely eliminate these incentives, additional rules and safeguards, such as the OI&M rules, are necessary to limit the incumbent LECs' *ability* to misallocate costs to the detriment of captive ratepayers and competitors. That is why the Commission re-affirmed, in the same orders that promulgated the OI&M rules and other rules implementing Section 272, that the Commission has already rejected BellSouth's argument and determined that "interstate price cap regulation does *not* eliminate the need for cost allocation rules."[19] By the same token, the prohibition on OI&M remains necessary even with the existence of price caps.

Further, contrary to Qwest's claims, price cap regulation has not eliminated the incumbents' incentives to misallocate costs to their monopoly services. Indeed, the most that Qwest can claim is that regulation has "largely alleviated" the link between costs and rates (Pet. at 14) – but that admits that numerous links between costs and prices are still in place, and

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[19] *Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd. 17539, ¶¶ 58, 271 (1996) ("*Accounting Safeguards Order*") (emphasis added). Further, the Commission's determination to create an outright ban on OI&M, rather than attempt to police cost misallocation in other ways is surely appropriate. The Commission has recognized since at least 1983 that "sharing of such services would require 'excessive, costly, and burdensome regulatory involvement in the operation, plans, and day-to-day activities of the carrier [in order] to audit and monitor the accounting plans necessary for such sharing to take place.'" *Non-Accounting Safeguards Order* ¶ 163 (quoting *BOC Separations Order*, 95 F.C.C.2d 1144, ¶ 70). Rather than attempt to engage in such oversight, the Commission properly determined to ban joint OI&M altogether. *See also Non-Accounting Safeguards Third Order On Reconsideration*, ¶ 20 (recognizing "the burdensome regulatory involvement that would be necessary to detect and deter such cost misallocation").

therefore leave plenty of reasons why incumbents continue to have the incentive to inflate the costs of their regulated services and understate the costs of services that face some measure of competition. This is because, in practice, price cap regulation is effectively only a modified form of rate-of-return regulation. The "index" used to adjust rates is always subject to change by the regulator, and the typical basis for altering the index is that a company's costs have increased at a greater rate than the index. *See* Kenneth Train, *Optimal Regulation* 327 (1991) (under price cap regulation, a firm will have incentive to "waste so as to convince the regulator to allow a higher cap"). For that reason, as the Supreme Court held in 2002, "price caps do not eliminate gamesmanship," primarily because price caps are "simply . . . a rate-based offset" that, like rate-of-return regulation, still provides "monopolies too great an advantage." *Verizon Communications Inc.* v. *FCC*, 535 U.S. 467, 487-88 (2002). And this is no theoretical concern: because the CALLS plan is due to expire soon, the incumbents have powerful incentives to shift costs in order to support higher exchange access price caps going forward.

Further, as AT&T has previously pointed out, the incumbent LECs are not even subject to "perfect" price cap regulation and therefore retain strong incentives to pad costs of regulated services. First, some states continue rate of return regulation for intrastate services, and in those areas there is a direct link between the incumbents' costs and prices – and thus the tremendous incentive for incumbents to inflate the rate base. Further, even in states that have adopted price caps for intrastate services, many such state price cap systems have retained sharing or other periodic earnings reviews, which likewise create a direct link from the costs incurred to the rate increases.

In addition, even though the interstate price cap system no longer includes a sharing obligation, Qwest and other incumbent LECs would nonetheless obtain significant benefits by virtue of the fact that they could, in the absence of OI&M rules and other safeguards, misallocate costs to their regulated services. As described above, by manipulating its affiliates' costs to artificially low levels, an incumbent can effect price squeezes on its rivals even as it appears to comply with imputation requirements. Further, if Qwest and other incumbent LECs could shift a disproportionate share of the massive joint and common costs away from competitive services and onto regulated local services, they could be able to boost substantially prices for essential services, such as unbundled network elements, that they provide to downstream rivals.[20] For these reasons, even if "perfect" price cap regulation currently existed, price caps are not, by themselves, sufficient to eliminate incentives to misallocate costs. The Commission's OI&M rules are therefore vitally "necessary" to ensure just and reasonable rates and forbearance from those rules would patently violate section 10.[21]

B. The OI&M Rules Are Necessary To Protect Consumers

Because the OI&M rules prevent discrimination against other carriers, cost misallocation, price squeezes, and other anti-competitive abuses of bottleneck monopoly power, the rules promote competition and thus protect consumers. Qwest nevertheless contends that forbearance

[20] To be sure, Congress has prohibited the prices for network elements to be based on historical costs, *see* 47 U.S.C. § 252(d)(1), and the Commission has adopted TELRIC pricing rules that examine the costs incurred by an efficient carrier, but that has not prevented the incumbent LECs from advancing cost models and UNE prices that are purportedly consistent with the Act and those rules but that in fact are rife with backward-looking data based on the incumbents' actual costs.

[21] Qwest also points to the existence of other safeguards that it claims would adequately protect against anticompetitive conduct should the OI&M ban be lifted, but the Commission has rejected that claim repeatedly, in 1999 (*Non-Accounting Safeguards Third Order On Reconsideration*), in 1997 (Second Order On Reconsideration, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272*, 12 FCC Rcd. 8653, ¶¶ 11-12 (1997) ("*Non-Accounting Safeguards Second Order On Reconsideration*")), in 1996 (*Non-Accounting Safeguards Order*), and 1983 (*BOC Separations Order*); *see also AT&T July 9 Cost Ex Parte* at 6-8, 12-16 (demonstrating that other safeguards would not be effective and describing longstanding Commission precedent that structural remedies are only effective way to prevent this type of cost misallocation).

from the rules would serve consumers in two ways: by allowing Qwest to "compete more effectively" in the long distance market and to "streamline" OI&M functions for its customers and thereby improve customer service. Pet. at 15.

First, Qwest provides no evidence that it is not able to compete effectively in the long distance market because of the OI&M rules. To the contrary, it is widely reported that the BOCs have gained unprecedented market share since they have received authorization to offer long distance services. For example, according to Verizon, it had won 20 percent of the residential long distance market within one year of receiving section 271 authority in New York and 34.2 percent within two years. And Qwest does not appear to be any exception: it recently touted claims that it has signed up 1.12 million long distance customers in 2003. *See* http://www.qwest.com/about/media/pressroom/1,1720,1346_archive,00.html.

In this regard, it is difficult to comprehend how Qwest is prevented from competing effectively when it admits that it "incurs very few OI&M costs." Pet. at 7. Even if compliance with the OI&M safeguards were shown to cause the BOCs to incur significant costs (a showing that no BOC has ever made), those rules would still be necessary and thus inappropriate for forbearance because there is a "strong connection" between those safeguards and the protection of long distance competition.[22] Here, where the rules are imposing virtually no costs, there is no benefit to competition or to consumers that would arise from forbearance.

Second, Qwest's claims that it could serve its customers more effectively without the OI&M safeguards are incorrect and, in all events, insufficient to justify forbearance. Once again, Qwest's claim is virtually identical to claims that the Commission considered and rejected in

[22] *See Ex Parte* Letter from C. Frederick Beckner, Counsel to AT&T, to Marlene Dortch, FCC, at 3, CC Docket No. 96-149 (filed July 9, 2003) (citing *CTIA* v. *FCC*, 330 F.3d 502 (D.C. Cir. 2003)).

1996. *See*, *e.g.*, *Non-Accounting Safeguards Order*, ¶¶ 153, 163 (rejecting BOCs' claim that OI&M restriction is inappropriate because it will "result in a loss of efficiency and economies of scope, decreased innovation, and fewer new services"). Qwest presents no basis to revisit the issue, particularly since it admits that it incurs virtually no OI&M costs.

Further, and as AT&T has previously explained in response to other BOCs' forbearance petitions, neither Qwest nor other BOCs face a competitive disadvantage by virtue of the OI&M prohibition. Thus, whatever the costs and inefficiencies the OI&M requirement imposes on BOCs and their section 272 affiliates, they are *no different* than the costs and inefficiencies faced by the BOCs' competitors, and they are outweighed by the potential anticompetitive effects that would result if the OI&M requirements were eliminated prematurely. Competitors, which remain dependent on the BOC's network, also cannot respond as a single team to provide end-to-end service. In this regard, if there were any error in the Commission's original balancing of costs and benefits in this area, it is that the Commission *underestimated* the competitive harm arising from shared BOC/272 affiliate services, and allowed *too much* sharing and too many opportunities for anticompetitive cost misallocations and discrimination. Any added burdens of the OI&M requirement, therefore, do not and cannot place BOCs and their section 272 affiliates at any competitive disadvantage vis-à-vis their competitors; instead, as the Commission previously has found, it places them on equal footing.

C. Forbearance From The OI&M Rules Would Not Serve The Public Interest.

Finally, forbearance from applying the OI&M rules is not necessary to the public interest. Qwest makes no serious showing otherwise. *See* Pet. at 16. In first imposing the OI&M services restriction, the Commission found that it was needed to promote full and fair competition, further the public interest, and protect consumers (and competition) from anticompetitive BOC conduct. *See Non-Accounting Safeguards Order* ¶¶ 163, 167; *Non-Accounting Safeguards Second Order*

On Reconsideration, ¶¶ 12, 53; *Non-Accounting Safeguards Third Order On Reconsideration* ¶¶ 15, 20. The Commission found that anticompetitive discrimination would be an inevitable consequence of lifting the ban on shared OI&M services. *Non-Accounting Safeguards Order* ¶ 163. Similarly, the Commission determined that this ban was needed to avoid "improper cost allocation that Section 272 was designed to prevent." *Non-Accounting Safeguards Second Order On Reconsideration*, ¶ 12. Qwest's Petition presents no reasonable basis or cognizable evidence to justify the Commission changing its prior considered judgment.

CONCLUSION

For the reasons stated above, Qwest's petition should be denied.

Respectfully submitted,

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October 29, 2003

CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of October, 2003, I caused true and correct copies of the forgoing Opposition of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: October 29, 2003
Washington, D.C.

/s/ Peter M. Andros
Peter M. Andros

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November 15, 2002

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., TW-A-325
Washington, D.C. 20554

Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules,* CC Docket No. 96-149.

Dear Ms. Dortch:

This letter responds to arguments and information submitted by Verizon in its reply comments in the above-captioned proceeding. As detailed below and in the attached *ex parte* declaration of Dr. Lee Selwyn, there is no basis for the Commission to forbear enforcement of the section 272(b)(1) prohibition against a BOC and its section 272 affiliate sharing network operating, installation, and maintenance ("OI&M") functions.

Verizon continues to decline to provide supporting material for the only "new" information it even purports to submit – the alleged high costs of compliance with the OI&M restriction. Such unsupported cost claims are undeserving of any weight in this proceeding. Moreover, claims that the OI&M restriction hinders full and fair competition are belied by the reality of the marketplace, where BOCs have been able to capture substantial interLATA market shares shortly after receiving section 271 authority. Rather than hindering competition, the OI&M restriction promotes competition by attempting to ensure that the BOC competes on a level playing field, placing BOCs and their affiliates in the same position as their competitors in the local and interLATA markets.

The comments of AT&T and others demonstrated that eliminating the OI&M restriction would give BOCs a substantial and unfair advantage over fledgling local competitors and would allow the BOCs to leverage their monopoly power in local markets into the long distance market.[1] These competitors undisputedly depend, in the vast majority of circumstances, on a BOC's network facilities – and thus BOC OI&M services for those network facilities – to

[1] AT&T Comments at 5-7.

provide competing services. If BOCs and their section 272 affiliates could share OI&M functions, they would be able to provide end-to-end service functions unavailable to other competitors.

Verizon stresses that local exchanges are, by definition, "*open* to competitive entry" once 271 authority is granted, and thus a competing carrier may also "use its own facilities ... and use a single OI&M workforce to install, operate, and maintain those facilities."[2] As the Commission has frequently recognized, however, the mere fact that a local market is technically "open" does not rid the BOC of market power of mean that the local market is fully competitive. Indeed, the restrictions of section 272 are premised on the fact that section 271 allows BOCs to enter the interLATA market while they still command overwhelming market power, and thus "have both the incentive and ability to discriminate against competitors in incumbent LECs' retail markets."[3] The OI&M restriction, like the other section 272 restrictions, thus already assumes that local exchange markets are *open* to potential competition. Verizon's claim that the OI&M restriction is unnecessary simply because the *opportunity* exists for competition in its local exchange markets amounts to nothing more than a direct challenge to the statutory scheme, and provides no reason to forbear its enforcement.

Verizon's separate contention that facilities-based competition in fact "is flourishing,"[4] simply ignores the marketplace realities.[5] And Verizon's claim that there is a healthy percentage of facilities-based competition in the local exchange business market is based on a gross misreading of the BOCs' own overstated claims in their "UNE Fact Report."[6] As Dr. Selwyn establishes, Verizon's estimates of such facilities-based competition are based in part on a methodology that treats CLEC purchase of special access as the CLEC's self-deployment of their own loops, thereby vastly inflating the CLEC share of deployed facilities, even though, for purposes of OI&M services, the CLEC is as dependent upon the BOC for such services in the context of special access as it is with other BOC facilities.[7] Verizon's claims of significant facilities-based competition in the business market are wildly exaggerated, as has been established in the Commission's *UNE Triennial Review* proceeding.[8]

Verizon also places great weight on its claim that competition is thriving in certain markets where there is no similar OI&M restriction.[9] As Dr. Selwyn has detailed exhaustively,

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[2] Verizon Reply at 5.

[3] *SBC/Ameritech Merger Order* ¶¶ 12, 190; *Non-Accounting Safeguards Order*, ¶ 9.

[4] Verizon Reply at 5.

[5] Selwyn Reply Declaration, ¶¶ 4-13 (attached to AT&T Comments).

[6] *See* Verizon Reply 5-6 & n.3.

[7] Selwyn Ex Parte Dec. ¶¶ 21-23.

[8] Selwyn Ex Parte Dec. ¶ 21.

[9] Verizon Reply at 10-11.

however, Verizon depends on "apples to oranges" comparisons of disparate markets, and ignores its dominance of even these handpicked markets.[10] For example, the competitive advantages of operational integration in intraLATA markets is reflected by the fact that BOCs continue to hold nearly a 50% market share despite the clear disadvantage that, before BOCs gain section 271 authority, *all* of their intraLATA toll customers are required to select a separate interLATA carrier.[11] Once BOCs receive section 271 authority, however, they will be able fully to leverage such competitive advantages, as reflected by certain BOCs' recent successes in regaining intraLATA market shares they had lost.[12]

Similarly, Verizon claims that BOCs retain relatively small shares of the information services markets. In fact, the BOCs dominate the market sectors where they have chosen to compete (such as single mailbox services to residential and small business customers and DSL-based high speed Internet access).[13] Moreover, the BOCs' inability to dominate the provision of other information services springs from market factors that are wholly independent of the BOCs' ability to provide integrated service with no OI&M restriction.[14]

At its core, Verizon's reply continues to rely most heavily on a rehash of the same arguments the BOCs presented (and the Commission rejected) in challenging the OI&M rule at multiple stages of the *Non-Accounting Safeguards* proceedings.[15] Thus, Verizon asserts that section 272(b)(1)'s requirement that the BOC and section 272 affiliate "operate independently" cannot be read to include the OI&M restriction,[16] and that other non-structural section 272 requirements make the OI&M restriction unnecessary.[17] The Commission has already responded to each of these contentions, and has provided more than adequate support for its interpretation of section 272(b)(1) as precluding shared OI&M functions. Applying traditional rules of statutory construction,[18] the Commission stressed that shared OI&M services would "inevitably"

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[10] Selwyn Ex Parte Dec. ¶¶ 27-40.

[11] Selwyn Ex Parte Dec. ¶ 31.

[12] Selwyn Ex Parte Dec. ¶ 32.

[13] Selwyn Ex Parte Dec. ¶¶ 34, 36.

[14] Selwyn Ex Parte Dec. ¶¶ 34-36.

[15] *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12; *Non-Accounting Safeguards Third Order On Reconsideration*, ¶ 20.

[16] *E.g.* Verizon Reply at 13 ("[I]f Congress had intended to prohibit sharing of OI&M services, it would have done so in section 272 explicitly ... .").

[17] *E.g.* Verizon Reply at 12-13 (claiming that section 272(e)'s nondiscrimination requirements already "prevent discrimination in favor of the section 272 separate affiliate."); *id.* at 16 (arguing that Verizon is prevented from "misallocating its costs" through the Commission's "accounting rules, cost allocation manuals, and biennial cost allocation audits").

[18] *E.g. Non-Accounting Safeguards Order* ¶ 155 (recognizing that this interpretation of operate-

lead to a level of BOC/affiliate integration that was precluded by the operate independently requirement of section 272(b)(1).[19] For example, such shared services "would inevitably afford access to the BOC's facilities that is superior to that granted to the affiliate's competitors."[20] The Commission separately recognized that allowing such shared OI&M services would create "substantial opportunities for improper cost allocation."[21]

Verizon dismisses these conclusions, asserting that (despite the Commission's repeated contrary findings) there is nothing unique about OI&M network services that justifies treatment different than other administrative services where the Commission has approve sharing.[22] Verizon provides no analysis, however, for this blanket charge that the Commission was mistaken when it deemed the BOCs' networks, and services directly concerning those networks, fundamentally different than other BOC services. These network facilities are the basis for the BOCs' market power, and are virtually always required inputs for the BOCs' competitors. The Commission has long recognized that network-specific functions are especially susceptible to BOC discrimination with potentially devastating consequences for competitors dependent on these facilities.[23] The Commission likewise long ago recognized the unique opportunities for cost misallocation concerning network services and related expenses.[24] Until the BOCs' control of bottleneck local facilities dissipates, therefore, the OI&M restriction (like the related bar on joint ownership of network facilities) is a necessary corollary to any requirement that a BOC and affiliate "operate independently."

Nor are the other requirements of section 272 (such as section 272(e)'s nondiscrimination requirement) adequate substitutes for the type of structural separation imposed by the OI&M and other "operate independently" requirements under section 272(b)(1). Enforcement of such nonstructural requirements require both detection and an effective complaint process. Moreover, by the time the complaint process has run its course, the damage to competitors and competition is done. And the BOCs have shown a willingness to breach and endlessly litigate enforcement of even their clearest legal obligations, as reflected in the Commission's recent imposition of a

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independently requirement "is based on the principle of statutory construction that a statute should be construed so as to give effect to each of its provisions"); *id.* ¶ 156 (reasoning that the "structural differences in the organization of [sections 272(b) and 274(b)] suggest that the term 'operate independently' in section 272(b)(1) should not be interpreted to impose the same obligations ... as section 272(b)").

[19] *Non-Accounting Safeguards Order* ¶ 163.

[20] *Non-Accounting Safeguards Order* ¶ 163.

[21] *Non-Accounting Safeguards Order* ¶ 163.

[22] Verizon Reply at 12-13; 16-17.

[23] *E.g. Non-Accounting Safeguards Order*, ¶¶ 158-166.

[24] *See BOC Separations Order*, 95 F.C.C. 2d 1117, 1144 (¶ 70) (1983).

record-setting $6 million fine against SBC for having "willfully and repeatedly" violated the "plain" conditions of the SBC/Ameritech merger.[25] Similar repeated BOC violations have led the California Public Utilities Commission, for example, recently to recognize that its "confidence in non-structural safeguards has waned significantly over the past years."[26] This Commission also has elsewhere stressed the need for structural safeguards, because BOCs can discriminate in a myriad subtle forms, and it is "impossible for the Commission to foresee every possible type of discrimination."[27]

Verizon also claims that structural safeguards like the OI&M restriction are unnecessary because it typically operates under price-cap regimes and thus "has no incentive to misallocate the costs of its competitive services to regulated accounts."[28] Dr. Selwyn demonstrates, however, that price caps can, in fact, *increase* the incentives for cost misallocation.[29] Under a price cap regime, a BOC has freedom to shift profits from one affiliate "pocket" to another without ever being forced to pass through "excess" profits to regulated customers.[30] Thus, for example, a BOC could overcharge its section 272 affiliate for services it also provides to competing IXCs (and thereby set an unfairly high rate for competitors under section 272(e)), while separately undercharging the affiliate for services it does not provide to competitors, all without a concern about how such pricing would impact the rates it charged regulated customers.

Perhaps most tellingly, Verizon continues to refuse to provide backup support for its claims that elimination of the OI&M restriction will save it well over $100 million.[31] Instead,

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[25] In the Matter of SBC Communications, Inc. Apparent Liability for Forfeiture, File No. EB-01-IH-0030, FCC 02-282 (rel. Oct. 9, 2002), ¶ 1. As the Commission concluded: "In state after state, throughout the Ameritech region, SBC force competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer, causing delays in the availability of shared transport." *Id.* ¶ 24.

[26] CPUC Decision 02-09-050, at 257 (September 19, 2002). Over just the past thirteen months, the California Public Utilities Commission has imposed fines against SBC of $27 million and $25 million – each records when imposed – for anticompetitive and unlawful conduct in California. *See The Utility Consumers' Action Network v. Pacific Bell* (U 1001 C), Case 98-04-004, Final Opinion on Pacific Bell's Marketing Practices and Strategies, D.01-09-058 (Sept. 20, 2001) ($25 million fine); *The Utility Consumers' Action Network v. Pacific Bell Telephone Company*, Case 02-01-007, Presiding Officer's Decision (Sept. 27, 2002) ($27 million fine, per settlement).

[27] *SBC-Ameritech Merger Order*, ¶ 206.

[28] Verizon Reply at 17.

[29] Selwyn Reply Dec. ¶¶ 35-36; Selwyn Ex Parte Dec. ¶¶ 45-46.

[30] Selwyn Reply Dec. ¶ 35.

[31] Verizon Reply at 18 (explaining it refused to include "backup data in its petition" because "these data are confidential" and disclosure would give competing carriers "insight into the

commenters and this Commission are called on simply to trust Verizon's cost claims. Given Verizon's pointed refusal to provide backup data it admits is available, the alleged cost-savings are entitled to no weight, and certainly cannot justify a finding that Verizon has met its forbearance burden.[32] Moreover, the supplemental information that Verizon has submitted undermines, rather than supports, the credibility of its cost estimates.[33] For example, Dr. Selwyn points out Verizon's cost-savings estimates rest in part on the claim that the section 272 affiliate would save *95%* of its expenses for third-party "professional services" because of OI&M integration. Yet no information or analysis is presented to support this astounding savings claim, which appears to ignore entirely the costs of additional Verizon technicians needed to perform such OI&M services.[34] Verizon's cost-savings claims, therefore, besides being unsupported, are on their face incredible and incomplete.[35]

But whatever costs and inefficiencies the OI&M requirement imposes on BOCs and their section 272 affiliates, they are *no different* than the costs and inefficiencies faced by the BOCs' competitors, and they are outweighed by the potential anticompetitive effects that would result if the OI&M requirements were eliminated prematurely. Competitors, dependent on the BOC's network, also cannot respond as a single team to provide end-to-end service. The added burdens of the OI&M requirement, therefore, do not and cannot place BOCs and their section 272 affiliates at any competitive disadvantage vis-à-vis their competitors; instead, it places them on equal footing. That the BOCs are not placed at any competitive disadvantage is shown conclusively both by their continued stranglehold on local exchange markets and by their success in expanding market shares in the long-distance market shortly after gaining section 271 authority. As AT&T showed in its opening comments, Verizon itself quickly gained up to 34.2% market share in long distance,[36] and SBC recently predicted its interLATA share would reach 30% within a year of market entry and exceed 60% after just three years.[37]

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company's cost of service").

[32] Verizon claims that such information is being withheld because it is "confidential" and could benefit its competitors if publicly disclosed (Verizon Reply at 18), but Verizon does not even attempt to explain why disclosure subject to a Commission protective order would not address these concerns.

[33] *See* Selwyn Ex Parte Dec. ¶¶ 4-7.

[34] Selwyn Ex Parte Dec. ¶ 4.

[35] *See* Selwyn Ex Parte Dec. ¶¶ 4-7.

[36] AT&T Comments at 4-5.

[37] Bear, Stearns & Co. Inc., Equity Research, *Highlights From Meeting With SBC Management* (Sept. 10, 2002). SBC had signed up 21% of its Texas access lines for SBC long distance through the first quarter of 2001 (nine months after gaining section 271 authority), and Verizon reported gaining a 17.9% long distance market share in Massachusetts ten months after gaining section 271 authority. Selwyn Reply Dec. ¶ 6.

Remarkably, Verizon contends that the BOCs' successes in entering the interLATA market "are beside the point," contending that they are the result of marketing and sales efforts and innovative pricing.[38] Yet the central purpose of all of the section 272 restrictions, including those regarding OI&M services, is to ensure that BOCs and competitors "compete on a level playing field."[39] Section 272 is not aimed at creating the most efficient, cost-effective way for BOCs to provide in-region and interLATA services. Rather its purpose is to ensure that competition (including long distance competition) remains healthy during the time period when the BOCs have 271 approval but also continue to dominate local markets.[40] That the BOCs are able to compete effectively in the interLATA market despite some costs imposed by section 272, including the OI&M requirement, is precisely the point, and shows that elimination of such requirements is unnecessary to promote full and fair competition.

Finally, Verizon makes no effort to establish, as it must under section 160, that elimination of the OI&M regulation will benefit consumers or is otherwise in the public interest. As shown by Dr. Selwyn, there is no reason to conclude on this record that any cost savings from an elimination of the OI&M requirement will be passed through to consumers.[41] The BOCs' continued domination of local exchange markets means that they would not be forced by competition to pass on such savings (especially given that the BOCs' nonfacilities-based competitors will continue to face their same OI&M costs). There also is serious reason to question that any such cost savings can or will be passed through to customers of the section 272 affiliate.[42] There simply is no record here to support the BOCs' bare assertion that any savings arising from an elimination of the OI&M requirement, unavailable to competitors of the BOCs and their section 272 affiliates in the current market, will further competition, reduce rates, or otherwise benefit consumers.

* * *

Under these circumstances, no reasonable basis exists for the Commission to reverse its previous considered judgment that the "operate independently" requirement of section 272(b)(1) bars shared OI&M functions by the BOCs and their section 272 affiliates. Nor have the BOCs

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[38] Verizon Reply at 8.

[39] *Texas 271 Order* ¶ 395.

[40] *E.g. Non-Accounting Safeguards Order* ¶ 9 (recognizing that section 272's separate affiliate and related requirements are "designed, in the absence of full competition in the local exchange marketplace, to prohibit anticompetitive discrimination and cost-shifting"); *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 5 (same).

[41] Selwyn Ex Parte Dec. ¶¶ 8-11.

[42] Selwyn Ex Parte Dec. ¶¶ 7, 10.

presented evidence to justify forbearance of this important requirement under section 160. Verizon's petition for forbearance thus should be denied.

Sincerely,

/s/ David L. Lawson

David L. Lawson

Enclosure

Exhibit F

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Petition for Forbearance From The Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) Of The Commission's Rules	**CC Docket No. 96-149**

Ex Parte Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

November 15, 2002

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Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Petition of Verizon for Forbearance From The Prohibition of Sharing Operating, Installation and Maintenance Functions Under Section 53.203(a)(2) Of The Commission's Rules	**CC Docket No. 96-149**

EX PARTE DECLARATION OF LEE L. SELWYN

Introduction

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I submitted a Declaration on behalf of AT&T Corp. on August 5, 2002 in WC Docket 02-112, the Commission's *Notice of Proposed Rulemaking* regarding *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, and submitted a Reply Declaration in that proceeding on August 26, 2002. That same August 26, 2002 Reply Declaration was also submitted by AT&T in the instant proceeding, CC Docket No. 96-149. I have been asked by AT&T to prepare this *Ex Parte* Declaration responding specifically to certain assertions and opinions contained in the Reply Comments and accompanying Declarations submitted by Verizon Communications, Inc. ("Verizon") in the above-captioned matter on September 24, 2002.

2. With its Reply Comments, Verizon included, *inter alia*, a Declaration by Timothy J. Tardiff that purports "to respond to the economic arguments of those opposing Verizon's request that the FCC forbear from enforcing its current prohibition against Bell Operating Companies (BOCs) and their interLATA long distance affiliate sharing Operation, Installation, and Maintenance (OI&M) functions, with primary focus on the arguments proffered by Dr. Lee Selwyn."[1] In his Declaration, Dr. Tardiff opines that the OI&M restrictions are "unnecessary to ensure that long-distance services are competitive" and reiterates Verizon's contention that the Section 272(b)(1) "operate independently" requirement "impose[s] extra costs on BOCs."[2] As I shall demonstrate in this Declaration, Dr. Tardiff's various contentions and assertions misstate existing competitive conditions and operational practices, and are otherwise off-point and meritless.

There is no credible or verifiable proof of any cost savings from the integration of local and long distance OI&M functions, but even if such integration efficiencies were present, Verizon has not demonstrated that any such savings would be flowed through to consumers.

3. Verizon and Dr. Tardiff claim that the OI&M restriction "harms competition by handicapping the BOCs and by ultimately passing along the costs of this restriction to consumers."[3] They claim that this requirement "increas[es] the costs of production of firms subject to [the

1. Declaration of Timothy J. Tardiff on behalf of Verizon, September 24, 2002, at para. 2.

2. *Id.*, at para. 2.

3. *Id.*, at para. 4.

restrictions], thus denying consumers the full benefits of competition."[4] In support of its claim, Verizon offers a three-page Declaration together with a three-page Attachment by Fred Howard, President of Verizon Global Networks, Inc. ("GNI"). Mr. Howard testifies that "GNI would save approximately $183 million over the 2003 through 2006 time period by sharing [OI&M] services with the BOC."[5] This estimate, which Mr. Howard claims to be "conservative," is supported by the three-page attachment that provides what can best be described as "ball park" estimates of costs that GNI would avoid if the specified function was, in each case, carried out by the BOC.

4. For example, Mr. Howard's Attachment notes that, for Professional Services, Mr. Howard claims savings from OI&M integration of *95%*, explaining that:

> Professional Services consist of the expenses for third-party vendors, primarily to perform field work. If GNI had not been constrained by the Commission's rules prohibiting sharing of operating, installation, and maintenance functions with the BOC, this cost could have been avoided almost entirely by using existing BOC field technicians.[6]

Although Mr. Howard is entirely silent as to precisely how this "95% savings" would arise, it is difficult to imagine how BOC field technicians could perform the same "field work" *in 5% the time* that it would take GNI personnel or outside vendors to accomplish the equivalent functions. There are several possible explanations. Mr. Howard may have omitted from his analysis the

4. *Id.*, at para. 25.

5. Verizon Reply Comments, September 24, 2002, Attachment A, at para. 5.

6. *Id.*, at 2.

cost of the BOC personnel or the fact that, as required by 47 U.S.C. 272(b)(5), GNI would have to pay the BOC the fair market value of the services that the BOC provides. In this case, since GNI is apparently purchasing these services from "third-party vendors," the arm's length "fair market value" would be the price that GNI is currently paying to the non-affiliated providers of these services. Perhaps Mr. Howard is assuming that BOC field technicians have so much "free time" on their hands that these added responsibilities (of supporting Verizon's interLATA affiliate) would not require the BOC to recruit, train, and *pay* additional employees, or require significant overtime from current employees. That would, of course, indicate the presence of a major inefficiency within the BOC entity that has *nothing whatever to do with the required separation of OI&M functions*. In any event, there is no basis upon which the veracity of Mr. Howard's "95% savings" estimate can be tested or reproduced, and as such his statements are nothing more than numbers on a page, establishing *nothing* about the actual "savings" that Verizon might realize, *if any*, from OI&M integration.

5. In a similar vein, Mr. Howard claims that GNI could save 65% of the costs associated with the development of its own operations support systems ("OSS") because these systems "could have been developed through modification of the BOC systems and reused at a fraction of the costs incurred to develop new systems."[7] As with "Professional Services," no specific data or support is offered for this particular estimate. More to the point, there is no indication, from Mr. Howard's attachment, that he has included any "right-to-use fee" that the Verizon BOC might impose upon GNI for the ability to access and modify the BOC-owned systems. Indeed,

7. *Id.*

Verizon (and its predecessors Bell Atlantic and NYNEX) have in the past represented to this Commission and to a number of state commissions that substantial costs are involved in order to modify existing BOC OSSs to accommodate interactions with CLECs, and have argued that these added costs should be borne by CLECs.[8] Absent anything more specific than Mr. Howard's "ball park" figure of 65% OSS savings, Verizon's claims as to savings and efficiency gains through OI&M integration lack credibility and must be afforded zero weight.

6. Virtually all of the "categories" identified on Mr. Howard's Attachment A suffer from the same deficiencies. No specific basis or source is offered for the "savings estimates" that are presented, and there is no specific indication that any added costs that the BOC would incur upon acquiring the responsibility for each and all of these functions, let alone the *price* that the BOC would be required to charge GNI for these services pursuant to 47 U.S.C. 272(b)(5), have been included, if in fact they had even been considered at all. Accordingly, and without specifically addressing each expense category individually, it is clear that Mr. Howard's estimates of efficiency gains are devoid of credibility and should be dismissed by the Commission.

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8. *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the appropriate Avoided-Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts,* Before the Massachusetts Department of Telecommunications and Energy, Docket No. 01-20, Direct Testimony of Louis D. Minion (Verizon), May 4, 2001. In its *Order*, filed July 11, 2002, the Massachusetts Commission concurred that Verizon would realize costs for changing its OSS.

7. Verizon claims that structural separation of OI&M functions increases the long distance affiliate's OI&M service costs above the BOC's marginal cost of providing the service for the affiliate on an integrated basis.[9] However, the "marginal costs" that Verizon cites are in any event *not* the appropriate cost comparison in this case, and cannot be used to estimate the "cost savings" that Verizon would realize. Were Verizon to properly apply the "arm's length" requirements of Section 272(b)(5) as implemented by this Commission, Verizon's long distance affiliate would be required to purchase all non-tariffed services from the BOC at the higher of fully distributed cost or fair market value.[10] In the case of OI&M functions, the price that Verizon is currently paying third party contractors and/or the affiliate's cost of providing this service in-house provides a reasonable and accurate fair market value. Verizon LD would therefore recognize the same OI&M costs regardless of the entity providing the service and regardless of whether it was being provided on an integrated or a stand-alone basis.

8. Assuming that Verizon adheres to the Section 272(b)(5) "arm's length" requirement, whatever cost savings may result from OI&M integration with the BOC entity would necessarily inure solely to the BOC (because the affiliate's transfer price payment for integrated OI&M services should be the same as its costs of performing these same functions on a stand-alone basis). In that case, BOC customers will realize those (alleged) cost savings *if and only if* the BOC is required (by the state PUC) to pass them through to its monopoly service ratepayers in the form of lower rates, *something that is not typically required or even contemplated under*

9. Verizon Reply, at 1.

10. *Accounting Safeguards under the Telecommunications Act of 1996*, CC Docket No. 96-150, *Report and Order*, 11 FCC Rcd 17539, 17606-17607.

existing state PUC incentive regulation paradigms. If the long distance affiliate were to price its long distance services so as to pass through the savings from integration, that would amount to below-cost pricing relative to what is actually being — or that should be — recognized on the long distance entity's books.

9. Indeed, Dr. Tardiff himself notes that price cap regulation prevents efficiency benefits from flowing to ratepayers. Dr. Tardiff recognizes that price caps "supply stronger incentives on the part of the regulated firms to improve their efficiency, since they retain the benefits of any such cost reductions– subject of course to reexamination of the price cap formulas."[11] Dr. Tardiff's statement concedes that, under price cap regulation, the BOC would have no incentive *or requirement* to pass on revenues generated from provision of OI&M services to its affiliates to anyone but its shareholders. Verizon's only incentive to pass on revenues in the form of lower local costs would be if competitive pressures required Verizon to reduce its local service prices. Verizon has presented no evidence that it is unable to compete with CLECs in the local market at or near its current retail prices. In fact, Verizon has recently asked for (and received) local price *increases* in New York,[12] and has made similar proposals in several other states.[13]

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11. Tardiff, at para. 24.

12. Verizon Press Release, *New York PSC Approves Verizon Regulatory Plan, Company Announces First Basic Rate Increase in 11 Years,* February 27, 2002.

13. "Verizon Wants to Raise Local Rates," *The Standard-Times*, June 7, 2002, at A10; "Verizon to Change Various Telephone Rates Under Price Cap Filing," Missouri PSC Press Release, available at http://www.psc.state.mo.us/press/pr0177.pdf.

10. Verizon also has no incentive to lower long distance rates. Currently, IXCs must account for a number of costs when establishing long distance and integrated service consumer prices. Included in this calculation are, *inter alia,* access charges, non-access network switching and transport costs, billing and collection costs, marketing costs, and customer service costs. In an effectively competitive market, the offered prices would be expected to roughly correspond with the sum of these costs. High cost producers would be forced either to take steps to reduce costs or to exit the market. A low cost producer, on the other hand, would be able to retain as excess profits the difference between its costs and the prevailing industry cost level. These excess profits would be short lived. Ultimately, rivals would come to match the low cost producer's efficiencies, and those rivals would have an incentive to gain market share by reducing prices. This price reduction cannot be expected to occur, however, if a firm's cost reduction is based on a *unique* ability to operate at lower cost that is not available to other firms. In this situation, the low cost company would continue to reap excess profits until and unless its unique status was compromised.

11. A BOC's ability to provide local and long distance service on an integrated basis would be an example of a unique capability, which could persist until such time, if ever, that competing *local service providers* acquire a sufficiently large customer base, without marketing costs significantly higher than those of the BOCs, to allow for similar integration. With BOCs currently controlling 90% or more of the residential and small business local service market and with even the largest individual CLEC shares falling in the low single-digit percentage range, the ability of BOCs to retain such excess profits or, alternatively, to temporarily set long distance prices below

their rivals' costs for the purpose of rapidly gaining long distance market share, is likely to persist for many years to come.

Preliminary results of BOC long distance entry following Section 272 approval confirm that the BOCs will continue to monopolize the local market and will come to monopolize the long distance market as well.

12. Dr. Tardiff states that "[a]n ounce of .. actual experience is surely weightier than a pound of speculation about possible misdeeds and/or, predictions of re-monopolization."[14] What we have here, of course, is not just "an ounce of actual experience," but rather a *ton* of it, acquired in the aftermath of BOC interLATA entry following their receipt of Section 271 authority. That "actual experience" not only confirms prior concerns as to the inadequacy of existing structural and non-structural safeguards as *implemented* by the Commission, but shows that my original projections of BOC long distance market share growth following 271 authorization to have been *highly conservative*.[15] Affording Verizon the "forbearance" from the OI&M separation required by Section 272(b)(1) as applied by the Commission will serve only to accelerate the demise of competition and enable Verizon to further consolidate its already formidable stranglehold on the local telecommunications market and come to remonopolize the long distance market within its operating footprint. The inextricable linkage between Verizon's and SBC's success in rapidly acquiring long distance customers and the BOCs' continuing

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14. Tariff, at para. 7.

15. I have provided a model predicting a BOC's ability to gain in-region market share in the Virginia and New Jersey Section 271 cases before this Commission. In addition, this model was included in the records developed by Delaware and California during their section 271 proceedings.

dominance of the local service market in their respective service areas is indisputable. Virtually all of Verizon's and SBC's 16-million long distance customers are *also* their local service customers.[16] Neither firm actively markets long distance service to customers of other ILECs, or of CLECs within the BOCs' footprint.

13. That BOC remonopolization of long distance is a clear and present danger, and not mere speculation, can be easily demonstrated by looking at the experience in Connecticut. The Southern New England Telephone Company ("SNET") was not a "Bell Operating Company" subject to the 1984 break-up of the former Bell System.[17] SNET was never barred from offering long distance service, and has not been required to comply with the separate affiliate, code of conduct, or other BOC specific provisions. *SNET operates its local and long distance activities on a fully integrated basis*. Hence, SNET provides a useful benchmark against which the potential consequences of granting Verizon's petition may be evaluated. And, as it happens, the experience in Connecticut — the details of which were just recently disclosed by SBC at an October 24, 2002 conference call with financial analysts — serves to confirm the real possibility

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16. As of the end of the third quarter of 2002, Verizon reported that it had acquired 9.8-million long distance customers, and SBC reported that it was serving some 5.9-million customers. *Verizon Investor Quarterly*, 3rd Quarter 2002 Quarterly Report, October 25, 2002, ("*Verizon 3Q Report*") at 5; *SBC Investor Briefing*, 3rd Quarter 2002 Quarterly Report, October 24, 2002, ("*SBC 3Q Report*") at 5.

17. Neither SNET nor Cincinnati Bell were made parties to the MFJ. See *United States v. American Telephone and Telegraph Company, Western Electric Company, Inc., and Bell Telephone Laboratories, Inc.; United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company; United States of America v. American Telephone and Telegraph Company, et al.* Civil Action Nos. 74-1698, 82-0192, Misc. No. 82-0025 (PI), 552 F. Supp. 131, 228, 232 (Appendix A) (D.D.C 1982).

of BOC remonopolization of the long distance market, and directly contradicts and refutes Dr. Tardiff's unsupported contention that there is "no likelihood that history will repeat itself"[18] insofar as BOC remonopolization of the long distance market is concerned.

14. SNET began preliminary marketing efforts with respect to long distance service in approximately 1994[19] with a full-blown marketing program targeted at its retail consumer and small business local service customers beginning in early 1996, thus making Connecticut the most "mature" market in which a major ILEC with a near-statewide footprint offers local and long distance service on an integrated basis.

15. SNET was acquired by SBC Communications, Inc. in 1998.[20] In its third quarter 2002 conference call with financial analysts held on October 24,[21] SBC described its Connecticut long distance market share as "60-plus percent" and characterized that level as a "plateau market-

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18. Tardiff, at para. 5.

19. Previously, the Company cautiously entered the long distance market through an affiliate, SONECOR, whose activities were targeted primarily at larger business customers both within and outside of Connecticut.

20. *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; Southern New England Telecommunications Corporation, Transferor To SBC Communications, Inc., Transferee*, CC Docket No. 98-25, *Memorandum Opinion and Order*, Rel. October 23, 1998, 13 FCC Rcd. 21292.

21. *SBC Communications – 3Q 2002 Financial Release Conference Call,* October 24, 2002 ("*SBC 3Q Conference Call*"). (The audio file is available at: http://www.firstcallevents.com /service/ajwz368853844gf12.html)

share" that could be expected to be achieved in other such "mature" markets.[22] In response to a question from a participant in the conference call ("I am wondering if you have any insight into what your take rate is for LD among those customers who come in for the first time to order local service, which may be a better indicator of what long-term market share is for you guys?"), SBC also indicated that its "take rate" for long distance "tends to be in excess of 50 percent."[23]

16. Data from Verizon and from the other SBC states in which the BOCs have obtained interLATA authority indicate that Connecticut is anything but anomalous. Verizon has just announced that, as of the end of the third quarter of 2002, it has almost made its previously-announced year-end 2002 target of 10-million or more long distance customers.[24] Verizon consistently adds almost 800,000 new long distance customers per quarter.[25] Although Verizon does not release market penetration data for many of its most mature markets, the Company has announced that it has achieved over a 30% market share in New York in less than two years,[26] and has recently reported that it has already achieved a 9% consumer long distance market share

22. *Id.*

23. *Id.*

24. *Verizon 3Q Report,* at 4.

25. *Id.*, at 5.

26. *Verizon Communications Reports Solid 3Q Earnings and Provides Outlook for Remainder of 2001*, Verizon Press Release, October 30, 2001.

in Vermont and Maine after only three months following its entry into the long distance market in those states.[27]

17. SBC makes clear that this rapid market penetration growth in Connecticut is directly related to SBC/SNET's position as the monopoly local exchange service provider. The "in excess of 50 percent" take rate described by SBC's Randall Stephenson appears not to be related to the launch of SBC long distance services following Section 271 authority, nor does it correlate to the introduction of any new pricing plans or other SBC "innovations." Despite not entering any additional states, not introducing any new calling plans or implementing any new marketing initiatives in the third quarter of 2002, SBC's long distance affiliate nevertheless added 318,000 lines across the SBC "271" states during the third quarter of 2002, compared to 266,000 added in the second quarter.[28] It is likely that the vast majority of these increases are a result of marketing efforts by SBC local customer service representatives on inbound calls initiated by the customer for the purpose of ordering or otherwise dealing with *local* service matters unrelated to SBC long distance service.

27. *Verizon 3Q Report*, at 5.

28. *SBC 3Q Report,* at 5; *SBC Investor Briefing*, 2nd Quarter 2002 Quarterly Report, July 23, 2002, at 1.

SBC and Verizon present disingenuous claims regarding CLECs competitive advantage in providing integrated OI&M functions.

Verizon and SBC have announced significant successes in the business market.

18. Verizon argues that the OI&M restriction is particularly burdensome in the large business market.[29] Actual market experience, however, indicates that the BOCs are not suffering significant handicaps in this sector. In recent Quarterly statements, both SBC and Verizon touted their successes in acquiring interLATA business customers. SBC notes, for example, that:

> SBC's growth in business long-distance services continues to be strong. In the third quarter, business interLATA revenues in the five Southwestern Bell states grew more than 30 percent year over year, and interLATA revenues for medium- and large-business customers increased more than 80 percent sequentially from the second quarter this year, the company's largest sequential growth category to date.[30]

SBC has also had significant success with winback rates exceeding 50 percent in *both* the consumer and business market segments.[31]

19. Verizon's third quarter 2002 report also indicates that it is making inroads in the large business segment:

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29. *Verizon Petition for Forbearance*, filed August 5, 2002, at 6.

30. *SBC 3Q Report*, at 5.

31. *Id.*

> We also have significant enterprise market opportunity that will fully open up when we get complete 271 authorizations in all states. However, we are not waiting to develop these opportunities in states where we are permitted to provide LD services today. We have had several contract wins and are gaining traction with wins for interLATA data services on either a statewide or regional basis, where we have 271 relief, and we have very active pipeline of bids, as well. In the coming weeks you will be hearing more from us on how we plan to more actively address opportunities to gain market share in the enterprise business phase.[32]

Verizon's President and CEO recently boasted to financial analysts that "[w]hen we enter the business market for the full sweep and we focus on those customers that we're best positioned with, we'll get between 20 and 30 percent of the market in three years."[33] This "positioning" discussed by Verizon CEO Ivan Seidenberg directly relates to the ability of the BOC to integrate local and long distance facilities, leveraging older, legacy local services as opposed to the recently-acquired next-generation facilities being touted by Dr. Tardiff. Mr. Seidenberg noted that, due to segmentation in the business market, Verizon cannot meet the needs of "Tier One Global Markets" currently served by AT&T, Sprint and MCI. According to Seidenberg, Verizon does not have the networks required, and has no intention of building them.[34]

20. This long distance market success and the extraordinary rate of targeted penetration growth directly contradict Dr. Tardiff's assertion that "the OI&M restriction is especially

32. Verizon 3rd Quarter Earnings Conference Call Webcast, October 25, 2002. (The audio file is available at http://investor.verizon.com/news/20021025/)

33. Ivan Seidenberg, remarks at the Goldman Sachs Communacopia XI Conference, October 1, 2002. (The audio file is available at http://investor.verizon.com/news/20021001/)

34. *Id.*

onerous."[35] Dr. Tardiff and Verizon argue that they are "disadvantaged" relative to their CLEC rivals by virtue of the CLECs' ability, so they claim, to provide end-to-end service and perform end-to-end testing over the CLECs' own facilities, whereas for BOCs the OI&M restriction requires separation of the interLATA and "last mile" local access facilities. That claim, of course, presupposes that CLECs control massive quantities of "last mile" facilities which, in point of fact, they do not.[36]

Verizon greatly exaggerates the number of CLEC owned "last mile" facilities.

21. In the *UNE Triennial Review* as well as in various Section 271 consultative proceedings held at the state level, BOCs have sought to portray as extensive the overall quantity of CLEC services being furnished over CLEC-owned facilities by means of a calculation that subtracts resold lines, UNE-P lines, and UNE loops from an estimate of total CLEC lines that the BOCs have derived by mining data from E911 databases.[37] Testimony filed by AT&T in the

35. Tardiff, at para. 15.

36. Reply Declaration of Lee L. Selwyn in WC Docket No. 02-112 (AT&T), filed August 26, 2002, at para. 15-18.

37. Because BOC or other ILEC personnel typically administer the E911 database, they have the unique ability to access proprietary data that had been provided by each LEC *for the sole and specific purpose of populating the E911 database with information on the location of those LECs' customers*. In this regard and as an aside, ILECs' use of the carrier E911 database to extract market information is in itself evidence of an abuse of their monopoly position. There is a fundamentally unfair asymmetry in the fact that Verizon and the other BOCs, contrary to the express requirements of Section 222(b), utilize this proprietary data to make various claims in regulatory proceedings (and perhaps for other strategic purposes as well), but commenters are not afforded access to this data and are thus not able to evaluate the factual basis for the BOCs' claims. As a policy matter, allowing Verizon use of the E911 data for this purpose would (continued...)

Commission's *UNE Triennial Review* proceeding explain that Verizon's claims that CLECs provide between 11- and 19-million business lines over their own facilities misrepresent the facts. As AT&T explains:

> The ILECs can reach this conclusion only by using a Rube Goldberg methodology that treats *CLEC purchase of special access as the CLECs' self-deployment of their own loops*. Thus, once this patent flaw is corrected, the number of self-deployed loops calculated by the ILECs' approach drops to the minimal level reflected in the Commission's own data and the comments.[38]

22. The data being cited by Dr. Tardiff appears to rely upon the same ILEC-sponsored *UNE Fact Report*[39] that was proffered by the ILECs in the *UNE Triennial Review*. Basing his conclusions on this report inevitably grossly overstates the number of CLECs serving customers over their own last mile facilities. The *UNE Fact Report* grossly exaggerates the extent of facilities-based CLEC lines (1) by relying upon quantities of CLEC telephone *numbers* contained in E911

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37. (...continued)
undermine the competitive safeguard, set out at Section 222(b) of the federal Act, that "[a] telecommunications carrier that receives or obtains proprietary information from another carrier for purposes of providing any telecommunications service shall use such information only for such purpose, and shall not use such information for its own marketing efforts."

38. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147 ("*UNE Triennial Review*"), *Reply Comments of AT&T Corp.*, filed July 17, 2002, at 145.

39. *Review of the Section 251 Unbundling Obligation of Incumbent Local Exchange Carriers*, CC Docket 01-338; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket 96-98; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket 98-147, *UNE Fact Report 2002,* Submitted by BellSouth SBC, Qwest, and Verizon, April 2002.

databases, which overstate the total quantity of CLEC *lines* that actually exist; and (2) by including as CLEC-owned facilities the Special Access services that CLECs purchase from ILECs where CLEC use of UNEs is not permitted.[40]

23. Inasmuch as CLECs do not control anything close to the quantity of CLEC-owned facilities as Dr. Tardiff claims, a CLEC would be completely unable to provide integrated end-to-end services of the type being contemplated by Verizon, which owns "last mile" access facilities to literally *tens of millions* of residential and business locations. *The vast majority of CLEC and IXC "last mile" access connections are obtained from BOCs and other ILECs either as UNEs or, in the case of interexchange carriers, switched or special access services.* With respect to such serving arrangements, end-to-end testing and repair would be reported by the customer to its CLEC or IXC service provider, which would in turn be required to request service testing or repair over special access circuits from the BOC. This process is *exactly* the same process that Verizon requires from CLECs attempting end-to-end testing or repair over Verizon UNE or special access facilities. Verizon's *Petition* amounts to a request that the Commission allow Verizon to integrate operations on *millions of legacy monopoly local service lines*, and attempts to justify this request by citing isolated instances where CLECs are able to similarly integrate such services. Verizon's sought "remedy" is vastly out of proportion to any possible "harms" it suffers from the small number of CLECs able to provide integrated services.

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40. *Implementation of the Local Competition Provisions Of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Supplemental Order Clarification*, Rel. June 2, 2000, 15 FCC Rcd 9587.

Despite Dr. Tardiff's assertions of a changing telecommunications industry, the BOCs' stranglehold on local facilities, as well as entrenched regulatory definitions, make the divestiture of AT&T relevant to BOC long distance entry.

24. It is the millions of legacy monopoly "last mile" facilities that Dr. Tardiff pointedly ignores when he denies the unambiguous relationship between Sections 271-272 of the *Telecommunications Act of 1996* ("Act") and its predecessor the *Modification of Final Judgment* ("MFJ"). Dr. Tardiff offers the simplistic and largely irrelevant suggestion that "[b]ecause of changes in technology, law, regulation, and competition itself ... 2002 is not 1984."[41] 2002 is not 1984 and, to be sure, *some* things have indeed changed or evolved in the eighteen years following the break-up of the former Bell System. But what has not changed — and what Dr. Tardiff seeks to brush off — is the inescapable *fact* that the incumbent Bell Operating Companies persist in their overwhelming dominance of the local exchange service infrastructure nationwide. That is decidedly *not* what Congress expected to be the case some seven years following enactment of the 1996 legislation. Yet, since 1996 all that has occurred is that BOCs and other ILECs have become bigger (through mergers) and more powerful (through their persistent bottleneck control of core local network resources and seemingly limitless litigation to frustrate and delay CLEC efforts to access ILEC network resources), and competitors and the capital needed to support their efforts have been vanquished and have vanished. By conveniently ignoring this market reality, Dr. Tardiff advances his "2002 is not 1984" hyperbole as providing some sort of substantive basis for the Commission to dismiss the real and growing threat to competition in the telecommunications industry that exists today as a direct result of the continuing discriminatory and anticompetitive conduct on the part of the BOCs.

41. Tardiff, at para. 5.

25. Dr. Tardiff claims that the "old distinctions between intra- and interLATA services are increasingly meaningless."[42] The OI&M prohibition, according to Dr. Tardiff, attempts to maintain this antiquated distinction, forcing the BOCs to operate less efficiently. While Dr. Tardiff may be correct that, technologically, many of the old distinctions are no longer efficient, he omits the reality that regulation and competition have not kept up with technology. IntraLATA access charges, for example, are still being set well in excess of cost. By forcing competing carriers to pay these excessive access charges to the very same BOCs with which they compete, the historical local/toll distinctions are being maintained notwithstanding what could happen but for the BOCs' enduring local bottleneck.

26. November 13, 2002 Market convergence naturally benefits a company with over whelming dominance in one of the converging markets. Dr. Tardiff thus conveniently ignores and, where he can't, seeks to minimize and understate, the very real evidence of continuing BOC local dominance when he claims that "[i]n particular, there is no likelihood that history will repeat itself if regulations such as the OI&M restriction were not applied." But history *is* repeating itself. BOCs *are* using their continuing dominance of the local exchange service market to rapidly capture a correspondingly dominant position in the adjacent long distance market within a short time following their attainment of Section 271 in-region interLATA authority. BOCs *are* cross-subsidizing their long distance activities by failing to compensate their ILEC entities for the fair market value of the myriad of services that are being provided to the long distance affiliate including, in particular, preemptive access to "inbound" local service

42. *Id.*, at para. 26.

customers ordering new local service and, for that matter, to the entirety of the BOC's local service customer base. Dr. Tardiff and Verizon ignore or dismiss the *mountain of evidence* confirming that not only do the BOCs retain a virtual monopolies in local markets, but they are gaining interLATA market share so rapidly that they will soon come to remonopolize the interLATA market as well.[43]

Dr. Tardiff's examples of developing competition in the intraLATA, InterLATA corridor, information services and CPE markets do not provide probative evidence contradicting the trend toward BOC remonopolization of the long distance market.

27. Given Verizon's and SBC's own reports of success in marketing to medium and large business customers, it is unlikely that they are substantially burdened by OI&M separation requirements. In fact, SBC's recognition of the success of "winback" efforts on the business side (where presumably the customer had previously been served by a CLEC not subject to the OI&M restriction) indicates that customers either do not value the carrier's ability to provide end-to-end testing (which the BOCs claim that they are unable to do) or that competitors are similarly unable able to provide end-to-end testing because they, like the BOC's Section 272 affiliate, are required to obtain "last mile" connections from the BOC ILEC entity.

28. Verizon's attempt to link the Commission's previously successful efforts at introducing competition into BOC bottleneck monopolies ignores important factors that render any such comparisons meaningless. Verizon cites four examples of "comparable" markets where the

43. See discussion at paras. 12-17, *supra.*.

BOCs claim to have lost significant market share, despite their ability to provide these services on an operationally integrated basis with their local offerings.

InterLATA Corridor Traffic.

29. Under the terms of the MFJ, two "corridors" were established in the New York/New Jersey and Philadelphia/New Jersey metropolitan areas, respectively, within which the BOCs serving these areas (then Bell Atlantic and NYNEX, now Verizon) were permitted to carry inter-LATA traffic. However, upon implementation of interLATA equal access in the mid-1980s, *the so-called "corridor" traffic was subject to the same interLATA PIC as all other interLATA traffic*. Seeming to ignore this critically important fact, Dr. Tardiff notes that Bell Atlantic's ability to provide interLATA corridor traffic on an operationally integrated basis with its local services did not do anything to help it to retain market share, which has by now dropped to insignificant levels.[44] However, in the case of "corridor" calling, customers were *never* afforded the ability or opportunity to specify a separate "corridor" PIC. Hence, unless the caller made a special effort to "dial around" her selected interLATA PIC by using a 101-XXXX access code to use BOC "corridor" service (which among other things would require that the customer accurately identify particular calls as falling within the "corridor"),[45] those calls would

44. Tardiff, at para. 9.

45. Except for the New York end of the New York/New Jersey "corridor," which consisted specifically of the five New York City boroughs that could be easily identified by the '212' and later the '212' and '718' area codes (thus enabling northern New Jersey customers to readily determine that calls made to these area codes could be dialed as "corridor" calls), the northern New Jersey, Camden and Philadelphia portions of the corridors were subsets of the (then) '201',
(continued...)

automatically be routed to the caller's interLATA PIC. Contrary to Dr. Tardiff's "spin," the BOCs' lack of success in retaining "corridor" market share does not "disprove" the importance of the OI&M restriction in protecting competition, but rather confirms the extreme importance of dialing parity.

IntraLATA Toll.

30. Dr. Tardiff observes that there are no OI&M or other separation requirements applicable as between the BOCs' local and their *intraLATA* toll operations, and yet notes that the BOCs have lost substantial intraLATA market share since intraLATA equal access was implemented nationwide around 1999. He cites this loss of BOC market share as further evidence that OI&M integration does not provide the BOCs with any competitive advantage vis-a-vis competing IXCs.[46] The evidence shows otherwise.

31. Dialing parity does exist today with respect to intraLATA toll, and while competition is present, BOCs continue to dominate this segment. As discussed at considerable length in my August 5, 2002 Declaration in the 272 Sunset proceeding,[47] intraLATA toll/local integration permits the BOCs to provide end-to-end service *without utilizing switched access services* of the

45. (...continued)
'609', and '215' area codes, respectively, making it extremely difficult for a customer dialing a "corridor" number to readily associate a given call to these NPAs as presenting a BOC "corridor service" option.

46. Tardiff, at para. 8.

47. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements,* WC Docket No. 02-112, Declaration of Lee L. Selwyn, filed August 5, 2002, at paras. 58-59.

type that are provided to IXCs, and in so doing gain cost and operational advantages that have enabled BOCs to offer retail intraLATA services at or below access charge levels. In fact, Dr. Tardiff appears to concede this point, noting that IXCs "had to compete against inexpensive local calling within the LATA"[48] Although IXCs have been successful in encouraging many customers to select the IXC for both intraLATA and interLATA service, the fact that the BOCs continue to provide intraLATA toll to nearly half of all local service customers *even though 100% of those customers are required to affirmatively select a separate interLATA carrier* serves to underscore the enormous value of the BOCs' incumbency and operational integration.[49] If OI&M separation is eliminated, BOCs will acquire the same capabilities with respect to *inter-LATA* services as they have enjoyed with respect to *intraLATA* — the ability to provide inter-LATA services on an end-to-end basis without the need to purchase and utilize the same types of

48. Tardiff, at para. 8. In New Jersey, for example, Verizon customers can purchase "Selective Calling Service" affording up to eight (8) hours of flat-rate calling (and low per-minute rates for usage in excess of that level) to nearby exchanges that would otherwise be subject to toll charges. Rates for Selective Calling service may be as low as $5.83 for a 24 hour block-of-time to three nearby exchanges, amounting to as little as $0.004 per minute (Verizon New Jersey Inc, Tariff B.P.U.- N.J. No. 2, Exchange and Network Services, Sixth Revised page 21, effective June 18, 2001). Verizon's intraLATA switched access charges that an IXC would pay to provide an intraLATA call in New Jersey amount to $0.017868. Verizon New Jersey Inc. B.P.U. NJ Tariff No. 2, Exchange and Network Services, Sixth Revised Page 21, Effective June 18, 2001. Similar optional expanded local calling plans can be found in other states, including Massachusetts (New England Telephone and Telegraph Company, MADTE No. 10, Exchange and Network Services, Part A Section 10, effective July 14, 1999).

49. Dr. Tardiff puts BOC intraLATA toll *revenue* shares at roughly 45%. Tardiff, at fn. 10. Since IXC shares include services furnished to customers over special access facilities leased from ILECs, the BOC share of the "dial-1" intraLATA toll market is undoubtedly well in excess of that 45% level. Additionally, the "toll" revenues cited by Tardiff *exclude* BOC revenues gained from optional expanded *local* services that themselves compete with IXC-provided intra-LATA toll and that BOCs are able to provide at below-access-charge prices specifically because of their ability to integrate the access and interexchange functions.

switched and special access services *that all nonaffiliated interexchange carriers must utilize in order to originate and terminate interLATA calls from and to BOC end user customers.*

32. Significantly, BOC entry into the *interLATA* market appears to have reversed the downward trend they had been experiencing with respect to *intraLATA* market share. Verizon's latest quarterly report indicates that BOC interLATA authority is halting the effect of intraLATA dialing parity on competition in the intraLATA market, reporting a net gain in intraLATA customers for each of the past five quarters.[50] Dr. Tardiff's analysis of the development of intraLATA toll competition using non-structural safeguards omits other facts regarding ILEC intraLATA toll pricing, special access services, and recent experience with the intraLATA toll market. For one, he claims that BOC intraLATA market share losses pre-dated equal access, citing a figure of 22% IXC share as far back as 1995.[51] Larger business users, whose aggregate long distance calling volumes were sufficient to justify the use of a dedicated connection between their premises and the IXC and who were thus not impacted by the lack of intraLATA dialing parity, often combined interLATA and intraLATA calling within the same service package. As a result, and especially before the introduction of equal access, the majority of BOC intraLATA market share losses through 1995 as cited by Dr. Tardiff consisted primarily of customers served over special access arrangements. Up until the implementation of intraLATA equal access presubscription and dialing parity, IXC shares of dial intraLATA toll were negligible. It was only after the introduction of intraLATA dialing parity, and requirements in the

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50. *Verizon 3Q Report*, at 5.

51. Tardiff, at para. 9.

1996 *Act* and elsewhere demanding the elimination of access charge subsidies, that intraLATA competition became viable on a large scale and to residential users. But even today, the continuing ability of BOCs to provide intraLATA services on an integrated basis, to avoid paying access charges or even imputing such charges into their retail prices, and to offer "non-toll" optional expanded local calling arrangements that compete directly with IXC intraLATA toll services, have all worked to ensure continuing BOC dominance of the intraLATA services sector.

Information Services.

33. Dr. Tardiff observes that while BOCs are permitted to offer "information services" on an integrated basis with no OI&M separation requirements, they nevertheless maintain only a small share of the information services market. For example, Dr. Tardiff puts BOC (and GTE) shares of "voice mail" services at only 15% and notes that there are "hundreds of non-affiliated Internet service providers (ISPs)."[52]

34. In claiming that BOCs maintain only a 15% share of voice mail revenues, it is likely that Dr. Tardiff has applied an unduly expansive market definition that includes segments that BOCs do not specifically target or even serve. With respect to voice mail, BOCs are primarily engaged in *retail*-level individual mailbox offerings targeted to BOC residential and single-line business customers. BOCs do not typically compete for voice mail business from purchasers of multiple mailboxes, such as PBX users. BOCs also do not typically compete for voice mail

52. *Id.*, at para. 10.

business from paging or CMRS carriers or from CLECs. The primary value of BOC operational integration with respect to voice mail lies in the single mailbox services provided to the residential and small business market, and BOCs appear to dominate this sector.[53]

35. Dr. Tardiff does, however, conveniently *ignore* the one critically important aspect of BOC-provided ISP access — ADSL — in which the BOC *is* able to exert market power and leverage its control of the local market into the adjacent competitive market for Internet access. In fact, BOCs have come to *dominate* the growing ADSL-based "high-speed Internet access" market.[54]

Customer premises equipment (CPE) and inside wire.

36. At the time of the break-up of the former Bell System, the BOCs were forced to transfer their "embedded base" of customer premises equipment ("CPE") to AT&T and were required to provide new CPE through a separate affiliate. Without that embedded base of CPE as a foun-

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53. Verizon notes that its "bundles" services are driving penetration of "basic" vertical features such as Caller ID, and Voice Mail. According to Verizon, over 19% of consumer customers subscribe to a bundle. Many more are likely to subscribe to BOC voice mail separate from a bundle. *Verizon 3Q Report*, at 5.

54. As of June 30, 2001, the RBOC share of ADSL lines was 86.4%. As a percentage of high speed lines, the BOCs provided 32.2% of all high speed lines. *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket 98-146, Third Report, Rel. February 6, 2002, at Table 5.

dation, the BOCs chose not to reenter the CPE market, and have still not done so even though, since 1996, the BOCs have been permitted to provide CPE on an integrated basis.

37. In 1977 and 1978, the FCC adopted the Part 68 "equipment registration" program applicable to *all* CPE, whether provided by a BOC or other ILEC, or by the customer.[55] That action, together with the subsequent "unbundling" of the "primary instrument" from the basic dial tone line and the transfer of embedded CPE out of the BOCs, fundamentally and irreversibly changed the distribution channel for both consumer and business CPE. Rather than renting telephone sets and other station equipment as part of the process of ordering local telephone service, consumers were instead offered the ability to *purchase* this equipment outright through ordinary retail channels, such as Radio Shacks, K-Marts, and thousands of other retail outlets. CPE so purchased could then be plugged into the customer's telephone line in much the same way as electrical appliances were plugged into the customer's electric service. As a result, CPE was no longer limited to the familiar telephone handsets that were the mainstay of ILEC-provided equipment, and thousands of new consumer-oriented products have been introduced, *each one of which may be connected to the PSTN via the standard RJ-11 interface*. Business telephone systems — PBXs and the like — experienced a corresponding restructuring of distribution channels, with numerous new manufacturers and their retail dealers entering the market.

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55. *Proposals for New or Revised Classes of Interstate and Foreign Message Toll Telephone Service (MTS) and Wide Area Telephone Service (WATS)*, Docket no. 19528, *Memorandum Opinion and Order*, Rel. June 20, 1977, 64 F.C.C.2d 1058; *Third Report and Order*, Rel. April 13, 1978, 67 F.C.C.2d 1255.

38. Put simply, the CPE "bottleneck" problem was solved by the simple adoption of the standard "RJ-11" plug and jack — and consumers and CPE providers don't even have to buy their RJ-11 jacks from the phone company, because the Commission had also deregulated another CPE-related bottleneck — inside wire. Since CPE interconnection is now accomplished by a standard RJ-11 plug-and-jack and since these products are now being sold by retail channels ranging from local convenience stores to specialized consumer electronics dealers, there is no particular cost or competitive benefit that a BOC could derive from the OI&M and marketing integration that is now permitted for CPE, and indeed no such integration has actually occurred because the BOCs are not in the CPE business to begin with. Thus, contrary to Dr. Tardiff's "example," the fact that CPE may be provided and marketed by BOCs on an integrated basis with local telephone service teaches *nothing* about what the BOCs will be able to achieve with respect to long distance remonopolization should the OI&M restriction be lifted with respect to interLATA services.

39. While Dr. Tardiff makes the affirmative statement that "[t]here is no evidence — nor have there, to our knowledge, ever been assertions" that the BOCs have attempted to exclude competitors in CPE,[56] Dr. Tardiff makes no such statement regarding inside wiring services. As with CPE, the BOCs do not have market power with respect to inside wire maintenance because there are no barriers to entry.[57] Interestingly, ILECs *have* attempted to preserve their preexisting

56. Tardiff, at para. 11.

57. *Detariffing the Installation and Maintenance of Inside Wiring*, CC Docket 79-105, Second Report and Order, March 12, 1986, 51 FR 8498 ("*Inside Wire Detariffing Order*"), recon, in part, Detariffing Recon., 1 FCC Rcd at 1190; further recon., Memorandum Opinion and (continued...)

monopoly in the inside wire maintenance business by exploiting preexisting relationships with monopoly local service customers, such as in attempting to sell deregulated "inside wire maintenance services' on inbound contacts from local service customers. For example, the California PUC has received numerous complaints that Pacific Bell ignores exactly the type of non-structural safeguards that Dr. Tardiff claims are successful in preventing monopoly abuses. As a non-structural safeguard, the California PUC required "the utilities to inform their customers that competitive alternatives may be available. This notification should be provided during customer calls to 611 repair services and when a repair employee is on the customer's premises and has identified a possible inside wire problem."[58] Complaints were lodged with the CPUC by the Office of the Ratepayer Advocate and The Utility Reform Network that Pacific Bell violated this safeguard.[59] Such complaints illustrate the inadequacies of non-structural safeguards. Other

57. (...continued)
Order, 3 FCC Rcd 1719.

58. *In the Matter of the Application of Pacific Bell, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California; And Related Matters*, Before the California Public Utilities Commission, Decision No. 90-06-069, June 20, 1990, 36 CPUC 2d 609, 626.

59. *In the Matter of the Application of Pacific Bell (U 1001 C), a corporation, for Authority to Categorize Business Inside Wire Repair, Interexchange Carrier Directory Assistance, Operator Assistance Service and Inmate Call Control Service as Category III Service; In the Matter of the Application of Pacific Bell (U 1001 C), a corporation, For Authority to Categorize Residential Inside Wire Repair as a Category III Service*, Before the California Public Utilities Commission, CPUC Decision No. 99-09-036, September 2, 1999, 1999 Cal. PUC LEXIS 603, *18. This requirement was clarified in *The Utility Consumers' Action Network, Complainant, vs. Pacific Bell (U 1001 C), Defendant; And Related Matters*, Before the California Public Utilities Commission, CPUC Decision No. 01-09-058, September 20, 2001, 2001 Cal. PUC LEXIS 914, *57. The CPUC did not make any findings or conclusions about Pacific's compliance with these requirements, however, the decision directs Pacific Bell to
(continued...)

BOCs have been accused of engaging in "negative option" marketing of their "optional" inside wire maintenance services, leaving the monthly charge on the customer's bill as of the deregulation date until such time as the customer affirmatively asks that the "service" be discontinued.[60]

BOCs have demonstrated their ability to engage in "double marginalization" by maximizing their profits with respect to their aggregate incremental costs rather than with respect to "imputed" access charges, and to effect price squeezes and engage in other predatory conduct with respect to nonaffiliated long distance rivals.

40. In my August 5 and 26, 2002 Declarations in WC Docket No. 02-112, I made reference to a recent paper by Prof. Jerry A. Hausman and others[61] in which the authors claimed that BOC long distance affiliates were offering service (in states with Section 271 authority) at lower prices than non-BOC-affiliated IXCs, and advanced as a theoretical explanation for this observed result the ability of BOCs to engage in "double marginalization" as between their ILEC and long distance operations. I noted that while I do not agree with the authors' claimed empirical findings as to price relationships, "if the Commission were to end the requirement that the BOC

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59. (...continued)
disclose such information. *See The Utility Consumers' Action Network, Complainant, vs. Pacific Bell (U 1001 C), Defendant. And Related Matters*, Before the California Public Utilities Commission, CPUC Decision No. 02-02-027, February 7, 2002, 2002 Cal. PUC LEXIS 189, *34.

60. *See, e.g. Pennsylvania Public Utility Commission v. The Bell Telephone Company of Pennsylvania*, Docket No. 832316, Before the Pennsylvania Public Utilities Commission, Opinion and Order, Rel. April 16, 1984, 1984 Pa. PUC LEXIS 53.

61. Jerry A. Hausman, Gregory K. Leonard and J. Gregory Sidak, "The Consumer-Welfare Benefits from Bell Company Entry into Long-Distance Telecommunications: Empirical Evidence from New York and Texas" ("Hausman/Leonard/Sidak" or "HLS"), unpublished study, dated May 2002.

operate its in-region long distance business out of a separate affiliate, and were no longer to require that the BOC long distance business activity operate independently with respect to, and transact all business at arm's length with, the BOC's local exchange operations, the BOC will be then capable of engaging in "double marginalization" pricing and in imposing a price squeeze with respect to access charges and retail long distance rates."[62]

Dr. Hausman's theory of double marginalization confirms a BOC's incentive and ability to engage in predation.

41. Dr. Tardiff's "response" to this observation, which is buried in a single footnote, suggests that my reference to the Hausman *et al* paper is "puzzling" and "internally inconsistent" because I dispute Hausman's empirical findings with respect to BOC long distance prices while at the same time appear to be accepting his explanation as to why BOC long distance prices are lower.[63] Dr. Tardiff once again misses the point: Hausman's contention that BOCs engage in profit-maximization across their combined local and long distance components represents an admission that BOCs do not adhere to access imputation requirements, such as those set out at 47 U.S.C. §272(e)(3). The fact that BOC long distance prices in the states studied by Hausman (New York and Texas) had not *as of that date* been reduced relative to pre-BOC entry IXC prices does not alter or diminish the importance of that admission. Significantly, while on the one hand contending that BOC prices satisfy access imputation requirements (*i.e.*, that BOCs are *not* engaging in "double marginalization"), Dr. Tardiff, also concedes, as I noted above, that

62. Reply Declaration of Lee L. Selwyn, at para. 32.

63. Tardiff, at para. 22, footnote 33.

IXCs "had to compete against inexpensive local calling within the LATA." The "local calling" to which Dr. Tardiff refers would appear to consist of calls placed within "optional" expanded local calling areas that compete directly with intraLATA toll services being provided by IXCs.[64] Unlike those "toll" services, however, these BOC "local" rates are not typically required to, and generally do not, exceed access charges, resulting in precisely the type of interLATA price squeeze vis-a-vis IXCs the existence of which is being denied by Dr. Tardiff.

42. The suggestion that BOCs profit-maximize with respect to *actual* incremental costs — not "opportunity costs" as claimed by Dr. Tardiff[65] — came not from me, but from BOC consultants Hausman, Leonard and Sidak.[66] Since the BOCs already have a relationship with the vast majority of customers that (absent BOC entry) would buy their long distance service from the IXCs, the incremental cost *to the BOC* of carrying these customers' long distance traffic, of marketing long distance to these customers, or of including long distance charges on its customers' local service bills, is considerably less when accomplished on an integrated basis than the stand-alone cost level that confronts an IXC without an extensive local service customer base. Because the demand for long distance service is downward sloping and not perfectly elastic, Hausman *et al* note that a BOC's profit-maximization point relative to its lower costs will be at a lower price than would be set by rivals that are confronted with volume-insensitive access

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64. See footnote 48, *supra*.

65. Tardiff, at para. 22.

66. *See*, Hausman/Leonard/Sidak, at 17.

charges, thus undercutting Dr. Tardiff's "opportunity cost" argument and resulting in precisely the type of price squeeze that I have described.

43. Double marginalization and the price squeezes that result therefrom are exactly the types of BOC conduct that Congress had in mind when it established the "operate independently" requirements at Section 272(b)(1). Dr. Tardiff and other BOC economists persist in their efforts to dismiss the possibility of predation and price squeezes being pursued by their clients if forbearance from the OI&M separation requirement is granted, and claim, among other things, that under price cap regulation the BOCs have no incentive to engage in anticompetitive conduct.[67] However, if their rhetoric had any merit, which it does not, there would have been no reason for Congress to have established separate affiliate, nondiscrimination, imputation and other safeguards *aimed precisely at limiting such potentially anticompetitive practices*. If through such devices the BOCs are successful in forcing their nonaffiliated rivals out of the long distance business, they will be in a position to increase long distance prices with little concern about competitive reaction. The requirements of Section 272 were designed to attenuate the BOCs' integration and incumbency advantages *while effective competition in the local market is developing*. Congress specifically recognized that, with respect to this aspect of BOC conduct, it is not merely sufficient for the market to be "open" to competition to protect consumers and competitors against anticompetitive pricing on the part of the BOCs.

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67. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, Comments filed August 5, 2002, *Verizon Comments*, at 18; *SBC Comments*, at 10-12; *Qwest Comments*, at 13.

Price Cap Regulations Creates Incentives to Misallocate costs.

44. Price cap regulation does not negate the possibility of cross-subsidization and predatory conduct; in fact, it works to support and sustain it. As I discussed in my August 26, 2002 Reply Declaration, under rate of return regulation if the BOC sets the price of an essential service (one that is subject to the Section 272(e)(3) imputation requirement) above cost, then its own "imputation payments" would be included in determining the appropriate price level for the remainder of its regulated services. Thus, if the BOC were to set an excessive price for switched access, for example, the excess profits resulting from imputation payments would have to be flowed through to its basic service ratepayers in the form of lower prices for other (retail) services. By contrast, under price caps, the BOC has no such requirement: It can overcharge its own competitive business unit without being forced to flow-through the excess profits resulting from this strategy; in effect, it will simply be shifting profits from one "pocket" into another. And in other situations, where the inter-affiliate transfer price is not used to establish the cash price that non-affiliated carriers would pay the BOC for like services (*e.g.*, because the BOC does not provide "like services" to the nonaffiliated carrier — joint marketing services, legal and lobbying services, are good examples), the BOC can *underprice* the services it provides to its affiliate, effectively negating the *overcharge* that it had applied where the transfer price matters (*i.e.*, where it is used as a basis for the cash price that nonaffiliated carriers pay for an essential service). The point is that under "pure" price caps, where the BOC is not subject to any cap on earnings or any obligation to share excess earnings, payments for inter-affiliate transfers have no economic or financial consequence for the corporation as a whole, they amount to shifting money from one pocket to another. And, of course, if the separate affiliate requirement is

allowed to sunset, the BOCs will no longer be under any obligation to post or otherwise make public — or for that matter even use — any "transfer prices" applicable to services furnished by the BOC to its (integrated) long distance business activity.

45. Significantly, empirical evidence shows that BOC market power in the local market remains pervasive enough to make "double marginalization" unnecessary at the present time. Dr. Tardiff states that the evidence presented in my Reply Declaration noting that SBC had *raised* is prices shortly after entering the long distance market "is not indicative of predatory behavior that would lead to monopolization, because in that instance, price increases occur *after* rivals have left the market."[68] Dr. Tardiff misses the point: SBC was *able* to raise its prices in the face of IXC competition precisely because its integration and incumbency were more than sufficient to overcome any negative demand consequences arising from its price increase. As I noted earlier, SBC has stated that it is signing up "in excess of 50 percent" of inbound local service customers for its long distance service as a result of its joint marketing program. With that sort of "take rate," it's no wonder that SBC raised its prices, because it obviously concluded that price was not the primary basis for customer choice of long distance carrier. If SBC felt that it was able to raise prices with a "take rate" that was only "in excess of 50 percent," it most certainly would have little concern about further price increases as that "take rate" improved, which is exactly what would occur as rival long distance carriers cut back on their marketing or exited the long distance business altogether. SBC's demonstrated ability to raise prices while concurrently increasing its overall market share attests to SBC's ability to extend its local market

68. Tardiff, at para. 22, fn. 34.

power into the long distance market — the essential ingredient for continued predatory pricing and anticompetitive conduct.

Conclusion

46. Verizon's sole basis for seeking Commission forbearance from enforcing the OI&M requirements of 47 U.S.C. §272(b)(1) are alleged cost savings arising from integrated operation, but the Company has provided no credible or verifiable support for the actual magnitude of savings that it claims will arise. On the other hand, there are serious and fundamental risks to competition in the long distance market that would arise if the OI&M separation requirements are rescinded prematurely, before the BOCs' extensive market power in the *local service market* is diminished. Additionally, and contrary to Verizon's contentions, even if Verizon's assessment of cost savings is accurate, there is no basis to assume or expect that such savings will in fact be flowed through to consumers. 47 U.S.C. §272(b)(5) *requires* that the long distance affiliate pay the BOC the fair market value of all BOC-provided services *whether furnished on an integrated basis or as specific interaffiliate transfers*. Accordingly, the affiliate should see no specific reduction in the transfer price it pays the BOC for these services and, indeed, if the integration gains were conferred upon the affiliate and were reflected in lower long distance prices to consumers, that would simply impose a price squeeze upon nonaffiliated IXC that do not have the local/long distance integration opportunity. If one then assumes that the integration gains would inure instead to the BOC ILEC entity, there is no requirement or expectation, as a result of the prevalence of price cap regulation at both the state and federal level, for the BOC to flow through those savings to its local service customers. Without any such flow-through, whatever

integration efficiencies may be realized would flow directly and entirely to Verizon's "bottom line." Accordingly, the only "beneficiary" of the alleged integration efficiencies would be Verizon's shareholders, but the risks to competition and to individual competitors are considerable and real. On the basis of a straightforward cost/benefit analysis, it should be apparently that Verizon's *Petition* must be denied.

The foregoing statements are true and correct to the best of my knowledge, information, and belief.

Lee L. Selwyn

Exhibit G

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July 9, 2003

***EX PARTE* – Electronically Filed**

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket 96-149

Dear Ms. Dortch:

I am writing to respond to Verizon's May 15, May 19, June 4, and June 24, 2003, *ex parte* filings regarding the "costs" that are purportedly caused by the Commission's rules that prohibit the sharing of operating, installation, and maintenance ("OI&M") services between a Bell operating company ("BOC") and its section 272 separate affiliate. As explained below, and in more detail in the accompanying declaration of Dr. Lee L. Selwyn ("Selwyn *Ex Parte* Dec."), Verizon's "cost study" is largely unverifiable *ipse dixit*. But even with regard to the few details that Verizon reveals, it is clear that Verizon's cost study can be given no weight. Verizon has apparently made no attempt to determine the overall firm-wide "costs" of the OI&M rules, but has simply calculated how much its section 272 affiliate would purportedly save if Verizon's BOCs were able to provide OI&M on its behalf – ignoring altogether the corresponding cost *increases* that the BOC would incur in taking over these functions. In other words, Verizon assumes that its BOC could provide *for free* the very same OI&M services that Verizon claims impose such enormous costs on its section 272 affiliate.

The Commission should not be bullied into overlooking Verizon's failure – in the eleven months since it filed its Petition – to support its claims that the OI&M safeguards are too costly to justify the clear public interest benefits that they provide. To the extent that the costs to Verizon are relevant, there remains ample time for Verizon to perform and submit proper cost studies that the parties and the Commission can then evaluate. Contrary to Verizon's claims, there is *no* impending statutory deadline for the Commission to act on Verizon's Petition. As the Commission has made clear, the 12 to 15 month statutory deadline imposed by section 10(c) of the Communications Act, 47 U.S.C. § 160(c), applies *only* to petitions that comply fully with the Commission rule governing the filing of such forbearance petitions, and Verizon's petition plainly does not comply with that rule. Commission Rule 1.53 states in full:

> In order to be considered as a petition for forbearance subject to the one-year deadline set forth in 47 U.S.C. § 160(c), any petition requesting that the Commission exercise its forbearance authority under 47 U.S.C. § 160 *shall* be filed as a separate pleading and *shall be identified in the caption of such pleading as a petition for forbearance under 47 U.S.C. § 160(c).* Any request which is not in compliance with this rule is deemed *not* to constitute a petition pursuant to 47 U.S.C. § 160(c), and is *not subject to the deadline set forth therein*.[1]

Verizon did not caption its Petition with the required reference to 47 U.S.C. § 160(c).[2] That is why the Public Notice issued by the Commission makes no mention of 47 U.S.C. § 160(c) in either the caption or the description of Verizon's Petition.[3] The statutory period for Commission decision will not even begin to run unless and until Verizon files an OI&M forbearance Petition that complies fully with Rule 1.53. Thus, the Commission need not cut short its evaluation of the continued need for OI&M safeguards – and could, for example, consider that issue as part of its broader ongoing consideration of the appropriate regulation of BOC long distance services.[4] And the Commission therefore should – indeed, must – reject any suggestion that superficial treatment of the cost issues raised by Verizon could be justified as necessary to meet a statutory deadline for decision.

Although the Commission could not, on this record, rationally grant the Petition, there are ample grounds to deny it now. As an initial matter, section 10(d) (47 U.S.C. § 160(d)) precludes the Commission from forbearing from the OI&M requirements in these circumstances.

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[1] 47 C.F.R. § 1.53 (emphasis added). *See also* 65 Fed. Reg. 7460 (Feb. 15, 2000) (due to "concern[] that the Commission and interested parties may not have sufficient opportunity to consider [forbearance] requests in a timely manner" if they are not "readily identifiable," Rule 1.53 requires forbearance petitions to be "clearly identified in the caption as a petition for forbearance under section 10(c) of the Act").

[2] Instead, Verizon chose to caption its petition merely as the "Petition of Verizon for Forbearance From the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Section 53.203(a)(2) of the Commission's Rules." *See* Verizon Petition for Forbearance (CC Docket No. 96-149, Aug. 5, 2002). Verizon knows how to caption its pleadings when it wants to trigger the statutory deadlines. *See* Petition for Expedited Forbearance of the Verizon Telephone Companies, at 1 (WC Docket 03-157, July 1, 2003).

[3] Public Notice, DA 02-1989 (Aug. 9, 2002).

[4] *See* Notice of Proposed Rulemaking, *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate And Related Requirements* (WC Docket No. 02-112, May 19, 2003).

Specifically, section 271(d)(3)(B) provides that the Commission may grant a BOC long distance authority only if the requested authorization "will be carried out in accordance with the requirements of section 272" of the Act. Verizon's Petition would thus require the Commission to forbear from applying section 271(d)(3)(B), because it would be seeking to provide interLATA services without having to comply with section 272(b) "operate independently" requirement that the OI&M rules implement. Section 10(d), however, expressly prohibits the Commission from forbearing from section 271 until that statute is "fully implemented" – a demanding standard that Verizon does not even claim to satisfy.[5]

Finally, as I explain in addressing specific questions posed to AT&T by the Commission's Staff, there are additional reasons why Verizon's petition should be denied. The record in this proceeding – as well as the numerous other proceedings in which the Commission has investigated the ability of the BOCs to leverage their bottlenecks into downstream markets – is clear that "[a]llowing a BOC to contract with the section 272 affiliate for operating, installation and maintenance services would inevitably afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors."[6]

I. VERIZON'S "COST" STUDIES

At the outset, it must be recognized that Verizon's cost evidence is legally irrelevant. Even if the Commission had discretion to forbear from section 271(d)(3)(B) and relieve Verizon of incorporated section 272 obligations, any claim that compliance with section 272 is "costly" does not advance Verizon's cause. Under section 10, forbearance requires an assessment of whether enforcement of the OI&M rules are "necessary" to prevent "unjust[] and unreasonably discriminatory" practices by Verizon,[7] and whether these regulations are "necessary" "for the protection of consumers."[8] No matter how costly compliance with the OI&M safeguards is claimed to be (and the record does not support Verizon's claims that the costs are in fact substantial), so long as there is a "strong connection" between those safeguards and the protection of long distance competition, they are "necessary" within the meaning of Section 10 and forbearance may not be granted.[9]

In all events, as Dr. Selwyn explains in the accompanying *ex parte* declaration, Verizon's "cost study" is baseless. Despite having had nearly a year to document its claimed cost savings,

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[5] *See Ex Parte* Letter from David Lawson, Counsel for AT&T, to Marlene Dortch, FCC (CC Docket No. 96-149, July 9, 2003).

[6] *Non-Accounting Safeguards Order*, 11 FCC Rcd. 21905, ¶ 163 (1996).

[7] 47 U.S.C. § 160(a).

[8] *Id.* § 160(a)(2).

[9] *Cellular Telecommunications & Internet Assoc. v. FCC*, No. 02-1264, slip op. at 17 (D.C. Cir. June 6, 2003).

Verizon has yet to have done so. Rather, the core of Verizon's "analysis" is a table that lists the percentages of expenses for various categories (*e.g.*, OSS, workforce) that Verizon claims are driven by the Commission's OI&M rules.[10] Verizon then applies these arbitrary figures to the total expenses Verizon claims that its section 272 affiliate (GNI) incurs for each expense category, with the results of that multiplication being the claimed overall "cost savings." Verizon provides no explanation as to how these percentages were derived other than to say that they were based on "assumptions" by "subject matter experts."[11] As a result, there is no way to test any of Verizon's assumptions, such as, for example, labor rates, capital costs, depreciation lives, and, most critically, whether the costs in question are actually "driven" by section 272 and the prohibition on OI&M sharing in particular. Nor is there any way to ascertain whether Verizon correctly and properly performed the mathematics it claimed to have undertaken. The Commission has made clear that such unverified *ipse dixit* does not establish "any record basis" to support agency action.[12]

But even the limited detail provided by Verizon exposes that its study is fundamentally flawed. To arrive at the "savings" from the elimination of the OI&M restrictions, Verizon simply calculated (in the flawed manner discussed above) the reduction in costs that GNI would achieve if the Verizon BOCs performed all OI&M-related activities currently performed by GNI. For example, Verizon states without explanation that the majority of OSS expenses for GNI are "driven" by section 272. On the other hand, nowhere does Verizon discuss the increased costs that it would incur by having its incumbent LEC operations perform the tasks that its 272 affiliate personnel previously performed. In other words, Verizon appears to have myopically focused only on the cost savings that the 272 affiliate would achieve from having the incumbent LEC provide OI&M on its behalf, without making any attempt to determine how *overall* firm-wide costs would be changed.[13]

Although Verizon is cagey on this point, it appears to justify this approach by claiming that the BOC has so much excess capacity that it could "absorb" the incremental work without any incremental cost.[14] This claim is astonishing. Verizon and the other BOCs have repeatedly claimed that "price cap" regulation ensures that they are operating efficiently. To the extent that

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[10] *See* Selwyn *Ex Parte* Dec. ¶¶ 3-4.

[11] *Ex Parte* Letter from Dee May, Verizon, to Marlene Dortch, FCC, at 6 (CC Docket No. 96-149, June 24, 2003) ("Verizon June 24, 2003 *Ex Parte*").

[12] *E.g.*, *AT&T Corp. v. Business Telecom, Inc.*, 16 FCC Rcd. 12312, ¶ 49 (2001).

[13] Selwyn *Ex Parte* Dec. ¶¶ 5-10. This is highlighted by the fact that Verizon asked only GNI employees to determine the level of costs savings that GNI would achieve from eliminating the OI&M rules; no comparable request was made of Verizon incumbent LEC employees as to how much additional work would be necessary to handle functions formerly being handled by GNI.

[14] Verizon June 24, 2003 *Ex Parte* at 7.

Verizon is maintaining excess capacity in its work force, systems, and other resources that is sufficient to absorb fully the additional OI&M demands of GNI, that is conclusive evidence that price cap regulation is not working as intended – and that Verizon has strong incentives to misallocate costs to its regulated local services.[15] Clearly, cost "savings" that are achieved only because of existing inefficiencies in Verizon's network operations are not a basis for eliminating the OI&M rules. And on the relevant issue of how much elimination of the OI&M rules would save a reasonably efficient carrier, Verizon has nothing to offer.

In any event, Verizon's claims regarding the costs of structural separation are undone by its own actions. Verizon has *voluntarily* created five different section 272 affiliates, each with its own OI&M resources, despite having a statutory obligation to create only one. Indeed, two of these affiliates, Verizon Global Solutions and Verizon Global Networks, Inc., apparently own switching facilities in the same cities.[16] That Verizon would have voluntarily chosen this structure gives the lie to its unsupported claims that the OI&M rules impose prohibitive costs. At a minimum, Verizon would need to prove that significant cost savings could not be achieved by integrating the five separate 272 entities into one single unit.[17]

II. ADDITIONAL ISSUES RAISED BY COMMISSION STAFF

In AT&T's May 2, 2003, meeting with the Commission's Staff, AT&T was asked to address several additional issues raised by Verizon's Petition. Each is addressed below.

The Record On OI&M Safeguards. Verizon claims that, when the OI&M safeguards were first "adopted, the Commission did not have a record to conduct a cost-benefit analysis of using structural separation as opposed to accounting safeguards."[18] This claim ignores not only the fact that the *Non-Accounting Safeguards Order*[19] specifically cited and discussed the evidence proffered by AT&T on this very issue, but also that the *Order* applied longstanding rules banning joint OI&M services that were developed in numerous, related proceedings in which the Commission and other regulators analyzed in detail both the costs and benefits of

[15] This is particularly true given Verizon's claims regarding the expected growth of GNI's services. Verizon June 24, 2003 *Ex Parte* at 12.

[16] Selwyn *Ex Parte* Dec. ¶ 22.

[17] Indeed, under Verizon's "absorption" theory, Verizon's other 272 affiliates could have sufficient capacity to handle GNI's OI&M. Thus, Verizon could potentially achieve all of its claimed savings simply by operating a single 272 affiliate rather that multiple 272 affiliates, as it currently does.

[18] *Ex Parte* Letter from Ann D. Berkowitz, Verizon, to Marlene Dortch, FCC, at 2 (CC Docket No. 96-149, May 15, 2003).

[19] *Non-Accounting Safeguards Order* ¶ 163 n.388.

structural separation.[20] In all of these proceedings, the prohibition against shared OI&M services rested on the fact that the BOCs controlled essential bottleneck facilities. Because Verizon does not (and cannot) seriously deny that it continues to control such facilities today, any departure from the Commission's existing rules and analyses would be unwarranted, arbitrary, and capricious.

In particular, well before the break up of the Bell System, the Commission was concerned that the Bell System would expand its dominance of local telephone markets to nascent "enhanced services" markets, as well as frustrate emerging competition for customer premises equipment ("CPE"). The Commission recognized that because many enhanced services could only be provided over last-mile facilities controlled by the Bell System, the Bell System had both the incentive and ability to leverage its local monopolies to gain market power in enhanced services markets. Likewise, the Commission was concerned that the Bell System would manipulate network architecture to frustrate CPE competitors. In order to protect competition and the public interest, the Commission initiated its landmark *Computer Inquiries* proceedings to study the conditions under which the Bell System would be permitted to participate in the enhanced services and CPE markets. And after "weighing" the "voluminous comments" on the costs and benefits of various options,[21] the Commission determined that the Bell System would be permitted to provide enhanced services and CPE only through a "separate subsidiary."[22]

In this regard, the Commission expressly rejected the Bell System's claims that "accounting" would be sufficient to prevent anticompetitive conduct. To the contrary, the Commission found that while accounting may assist in the detection of predatory behavior, it "cannot prevent" such behavior – only structural remedies could be effective.[23] Further, and of particular relevance here, the Commission expressly rejected the Bell System's claims that its subsidiary should be permitted to share OI&M services with its telephone operations to avoid increased maintenance and training costs. The Commission instead found that the imposition of such costs would be warranted on the grounds that the "manner in which enhanced services are provided and marketed are the two areas where the potential for anticompetitive behavior and misallocation of cost is great."[24]

Subsequently, in the wake of the break-up of the Bell System, the Commission initiated a new proceeding to study whether the *Computer Inquiries* obligations should be applied to the

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[20] *Id.* ¶¶ 163-164 nn.389, 390.

[21] *Computer II*, 77 F.C.C.2d 384, ¶ 84 (1980).

[22] *Id.* ¶¶ 190-200.

[23] *Id.* ¶ 210.

[24] *Id.* ¶¶ 238, 239.

Baby Bells. And again, after receiving voluminous, detailed testimony, the Commission reaffirmed its prior conclusions that

> the benefits to ratepayers and competition which can result from the requirements that CPE [and] enhanced services be offered through a limited form of separation outweigh the costs to the RBOCs of forming and operating through separate subsidiaries. Ratepayers will benefit not only through the reduction of common costs between regulated and unregulated operations, but also by the increased detection of any misallocation of costs between the two operations. In addition, competition should benefit since separate structure can reduce opportunities for anticompetitive conduct.[25]

Notably, the Commission re-imposed the separate subsidiary requirement on the BOCs' CPE operations despite the fact that the BOCs would be entering the CPE market with a zero market share.[26] And in so doing, the Commission rejected the request that "the separate subsidiary should be able to contract with regulated operations for the provision of engineering, installation and maintenance, and similar services," again finding that any costs imposed by this prohibition were warranted because of the ability of the BOCs to abuse "control over local exchange services."[27] In this regard, the Commission also observed that if it were to eliminate the prohibition on sharing OI&M services, it would be forced to engage in "excessive, costly and burdensome" auditing and monitoring of "day-to-day activities" of the BOCs in order to ensure that the BOCs were not using OI&M service as a tool for raising rivals' costs.[28]

In sum, contrary to Verizon's claims, the Commission's prohibition against OI&M sharing that it adopted in the *Non-Accounting Safeguards Order* was not only justified by the record before the Commission in 1996, but also by extensive, prior analyses of the costs and benefits of structural separation in general, and the OI&M prohibition in particular over a period of 20 years.[29] And while Verizon may be unhappy with the way in which the Commission weighed the costs and benefits of allowing a BOC to "share services" with its section 272

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[25] *BOC Separation Order*, 95 F.C.C.2d 1117, ¶ 3 (1983).

[26] *Id.* ¶ 70.

[27] *Id.* ¶¶ 45-46, 69.

[28] *Id.* ¶ 70.

[29] *See Non-Accounting Safeguards Order* ¶ 163 ("[a]llowing a BOC to contract with the section 272 affiliate for operating, installation, and maintenance services would inevitably afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors"); *Non-Accounting Safeguards Second Order On Reconsideration*, 12 FCC Rcd. 8653, ¶ 12 (1997); *Non-Accounting Safeguards Third Order On Reconsideration*, 14 FCC Rcd. 16299, ¶ 20 (1999).

affiliate, there can be no claim that such an analysis was not conducted. In undertaking to determine the extent to which a BOC's incumbent operations could provide services on behalf of its 272 affiliate, the Commission did *not* simply mechanically apply these longstanding rules and prior analyses, but tailored them to the section 272 context. For example, whereas the Commission had previously prohibited a BOC from providing marketing services on behalf of its CPE and enhanced services affiliates, the Commission declined to impose such a requirement pursuant to section 272.[30] Likewise, the Commission decided that the "economic benefits to consumers from allowing a BOC and its section 272 affiliate to derive the economies of scale and scope" in "the sharing of administrative and other services," "outweigh any potential for competitive harm created thereby."[31] Because it remains true that Verizon controls essential bottleneck facilities – as was the case in 1983 and in 1996 – the Commission's rules and analyses prohibiting joint OI&M remain fully applicable today.

The OI&M Safeguard Is Necessary To Avoid Discrimination And Cost Misallocation. Since *Computer II*, the Commission has recognized that a BOC can use its network facilities (and services directly concerning those networks) as a powerful tool for discriminating[32] and that those facilities provide the BOC with unique opportunities to engage in cost misallocation of network services and related expenses.[33] Further, the Commission has determined consistently for the past 20 years that – while non-accounting safeguards (such as the ban on shared OI&M) that are necessary to prevent a BOC from using network services to harm rivals may impose some costs on the BOC – the only alternative would be intensive "regulatory involvement . . . to detect and deter" such abuses that would be even more "burdensome" than such "structural" separation.[34]

As Dr. Selwyn describes in his accompanying declaration, the Commission's historic precedent is well-founded. Indeed, Verizon's claims that its existing incumbent telephone operations would simply "absorb" the functions now performed by the personnel of its separate affiliates prove that it would in fact engage in improper cost misallocation absent the OI&M restrictions. For example, according to Verizon, forbearance from the shared OI&M restriction would allow it to eliminate 34 technicians employed by its affiliates, whose work would be absorbed by the existing incumbent telephone operations at a mere five percent of the costs incurred by the affiliate. But as Dr. Selwyn points out, if Verizon's incumbent telephone

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[30] *Non-Accounting Safeguards Order* ¶ 168.

[31] *Id.*

[32] *See, e.g. Computer II* ¶¶ 238, 239; *Non-Accounting Safeguards Order* ¶¶ 158-166.

[33] *See, e.g.*, *BOC Separations Order* ¶ 70; *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20.

[34] *BOC Separations Order* ¶ 70; *see also Non-Accounting Safeguards Third Order On Reconsideration* ¶ 20.

personnel could in fact perform the incremental work of these 34 technicians with little added costs, then Verizon's incumbent telephone operations have excess capacity and are by definition inefficient.[35] Further, this excess capacity and "absorption" by the incumbent telephone operations would likely cause violations of the Commission's cost allocation rules.[36] As Dr. Selwyn explains, to absorb the affiliate's OI&M functions, the BOC might be required, for example, to undertake an expensive upgrade to ordering and provisioning systems that, after the upgrade, would be used to provide traditional local services and unregulated long distance services.[37] Under the Commission's cost allocation rules, however, Verizon could claim that the upgrade is a common cost that should be allocated on a "relative use" basis largely to its local service operations (even though the upgrade was not necessary to provide that functionality), thereby shifting the costs away from the competitive long distance operations and onto the monopoly local exchange services.

Dr. Selwyn also explains that the asserted benefits arising from forbearance and from integration of OI&M functions are, in fact, not benefits at all, but rather exemplify the superior access that Verizon's long distance operations would receive if OI&M functions could be shared.[38] For example, Verizon appears to claim that permitting shared OI&M could allow the BOC and its affiliate to bypass the established processes for ordering access services and allow the long distance operations to have direct access to the BOC ordering systems. But long distance carriers have repeatedly requested similar direct access, and claimed that the existing ordering processes are cumbersome and often unnecessary. Thus, if these cost savings could be achieved, then long distance carriers must also be given the same direct access (as section 272(e) requires). As Dr. Selwyn explains, the cost savings associated with this bypass therefore would not in fact result from actual integration efficiencies, but instead would be caused by the *elimination* of the contrived inefficiencies of the ordering process. On the other hand, if the BOCs are able to grant direct access only to their own long distance operations, and not to competing IXCs, then it is undeniable that allowing this sharing of OI&M "would inevitably afford access to the BOC's facilities that is superior to that granted to . . . competitors."[39] Thus, the ban on shared OI&M remains critical to prevent BOCs from discriminating in providing key long distance inputs like access and to ensure a level playing field between a BOC's long distance operations and those of unaffiliated competitors.

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[35] *See* Selwyn *Ex Parte* Dec. ¶ 9.

[36] *Id.* ¶¶ 14-19.

[37] *Id.* ¶ 18.

[38] *Id.* ¶¶ 20-21.

[39] *Non-Accounting Safeguards Order* ¶ 163.

Even The Cursory Biennial Audits That Have Been Conducted To Date Show Significant Discrimination And Cost Misallocation By The BOCs. The entire point of a structural prohibition like the ban on joint OI&M is to avoid excessive reliance on the "excessive, costly and burdensome" auditing of a BOC that would otherwise be required to detect and punish the cost misallocation and discrimination that the Commission has found "inevitably" would occur.[40] Thus, even if the audits conducted to date found no such misconduct, that would only demonstrate that the Commission's structural ban is effective – not that it is unnecessary, as Verizon claims. In order to avoid the need for detailed, "day-to-day" auditing and vigorous enforcement action to detect, punish, and deter cost misallocation and discrimination, the Commission should continue its OI&M prohibition.

Nevertheless, it is entirely appropriate to be concerned about the audits that have been conducted to date, because, as AT&T has explained in detail, they have been woefully inadequate even with the OI&M prohibition in place.[41] To begin with, the audit reports are not released until many months (or even years) after the audits are conducted. And the Commission has yet to impose any penalties on the BOCs as a result of the audits, despite significant findings of anticompetitive conduct. As a result, these biennial audits, at present, have no value whatsoever as a deterrent and could not possibly serve as an adequate "day-to-day" oversight mechanism that would be needed to ensure that the BOCs are not sharing OI&M in a discriminatory manner that raises rivals' costs.

Even beyond these significant shortcomings, the auditors failed to conduct the proper inquiries and gather the evidence necessary to test fully these BOCs' compliance with the key section 272 requirements. The audits were conducted pursuant to incomplete standards and procedures that were developed without the benefit of public comment and that have never even been publicly disclosed.[42] Indeed, with regard to OI&M sharing, the audit did not properly measure the BOCs' compliance even with the Commission's broad structural ban.

Specifically, under the General Standard Procedures the auditors were required to list services and employees in order to determine compliance with the OI&M safeguard. The Verizon 272 biennial audit of OI&M services, however, simply listed services as "Technical

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[40] *See Computer II* ¶¶ 70; *Non-Accounting Safeguards Order* ¶ 163.

[41] *See generally* Comments of AT&T Corp. on Verizon's Section 272 Compliance Biennial Audit Report (CC Docket No. 96-150, Apr. 8, 2002) ("AT&T Comments on Verizon 272 Audit"); Comments of AT&T Corp. on SBC's Section 272 Compliance Biennial Audit Report (CC Docket No. 96-150, Jan. 29, 2003) ("AT&T Comments on SBC 272 Audit").

[42] The General Standard Procedures used in the audit were established with BOC *but not public input*, and accordingly provided substantially less rigorous auditing criteria than the "Proposed Model" that was put out for public comment. *Proposed Model for Preliminary Biennial Audit Requirements*, 12 FCC Rcd. 13132 (1997).

Services" or "Telecommunications Services." These undefined categories are wholly inadequate to ascertain whether such services, rendered by the BOCs to the interLATA affiliates, constitute or include prohibited OI&M services.[43] Similarly, the SBC audit report indicated that: (1) SBC failed to provide the auditor with functional organizational charts for the Section 272 affiliate as of the audit date; (2) the auditor identified third party vendors who provided network planning and engineering to the Section 272 affiliate in the audit report only by letters A-L, making it impossible to verify whether these vendors were truly unaffiliated; and (3) SBC failed to disclose the individual locations where services were provided. If the audits could not assess compliance with the broad structural ban against OI&M, there is no hope that these BOC-designed audits would adequately detect BOC discrimination and cost misallocation when those services are shared and when detection of anticompetitive conduct would become far more difficult.

In this regard, even though the audits conducted to date were inadequate, they nonetheless shed enough light on the BOCs' practices to confirm pervasive discrimination with respect to the installation of access facilities – violations that could only be expected to grow worse if the OI&M safeguards were gutted. In one month, for example, Verizon provisioned high speed special access services for its affiliate in less than 10 days; non-affiliates waited more than 25 days.[44] That is no aberration – virtually *every* performance measurement disclosed in the audit reports shows that Verizon favored its affiliates over those affiliates' competitors.[45] Likewise, with respect to SBC, the audit revealed that with regard to completion of DS0 orders by the required due date, that SBC's affiliates received better performance in *each* of the last seven months audited – and the largest differences were in the last two months reported, confirming that SBC's performance was decreasing.[46] The data also show that SBC's return of firm order confirmations on DS1 and DS3 facilities were longer for SBC's rivals than for its affiliates in *all* 18 of the instances where the measure employed showed a performance difference. Likewise, for restoration of trouble SBC's competitors virtually always suffered longer delays than SBC's affiliates. For other measurements, too, SBC provided better service to its affiliates than to competing providers.[47]

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[43] *See* Auditor's Initial Biennial Report, Appendix A, Objective 1, Procedure 4 (CC Docket No. 96-150, June 11, 2001) (services also not listed in terms of *each* Section 272 affiliate). *See also* Auditor's Supplemental Biennial Report, Appendix C, Objective 1, Procedure 4 (CC Docket No. 96-150, Feb. 6, 2002).

[44] AT&T Comments on Verizon 272 Audit at 4.

[45] *Id.*

[46] AT&T Comments on SBC 272 Audit at 5.

[47] *Id.*

The Remaining Safeguards Are Insufficient To Detect And Deter Discrimination And Cost Misallocation. Verizon claims that other safeguards are sufficient to prevent discrimination and cost misallocation also have no merit. As explained below, these "conduct" provisions are not an adequate replacement for the OI&M "structural" separation.

Specifically, Verizon claims that section 272(e)'s non-discrimination requirement (and related "performance measures") is an adequate substitutes for the type of structural separation imposed by the OI&M (and other "operate independently") requirements. That is incorrect. Enforcement of such nonstructural, conduct requirements requires both detection of discrimination and an effective complaint process. However, by the time the complaint process has run its course, the damage to competitors and competition is done. And the BOCs have shown a willingness to breach and endlessly litigate enforcement of even their clearest legal obligations, as reflected in the Commission's imposition of a record-setting $6 million fine against SBC for having "willfully and repeatedly" violated the "plain" conditions of the SBC/Ameritech merger.[48] Similar repeated violations by the BOCs have led the California Public Utilities Commission, for example, to recognize that its "confidence in non-structural safeguards has waned significantly over the past years."[49] This Commission also has elsewhere stressed the need for structural safeguards, because BOCs can discriminate in a myriad subtle forms, and it is "impossible for the Commission to foresee every possible type of discrimination."[50]

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[48] *Forfeiture Order*, 17 FCC Rcd. 19923, ¶ 1 (2002). As the Commission concluded: "In state after state, throughout the Ameritech region, SBC force competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer, causing delays in the availability of shared transport." *Id.* ¶ 24.

[49] Decision Granting Pacific Bell Telephone Company's Renewed Motion for an Order that it has Substantially Satisfied the Requirements of the 14-Point Checklist in § 271 of the Telecommunications Act of 1996 and Denying that it has Satisfied § 709.2 of the Public Utilities Code, *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, CPUC Decision 02-09-050, R. 93-04-003 *et al.* at 265 (Cal. PUC, Sep. 19, 2002). The California Public Utilities Commission has imposed fines against SBC of $27 million and $25 million – each records when imposed – for anticompetitive and unlawful conduct in California. *See* Final Opinion on Pacific Bell's Marketing Practices and Strategies, *The Utility Consumers' Action Network v. Pacific Bell* (U 1001 C), Case 98-04-004, D.01-09-058 (Cal. PUC, Sep. 20, 2001) ($25 million fine); Presiding Officer's Decision, *The Utility Consumers' Action Network v. Pacific Bell Telephone Company*, Case 02-01-007 (Cal. PUC, Sep. 27, 2002) ($27 million fine, per settlement).

[50] *SBC/Ameritech Merger Order* 14 FCC Rcd. 14712, ¶ 206 (1999).

Indeed, even for the states that have enacted rigorous "performance measures" with self-executing penalties, the BOCs continue to find it advantageous to provide competitors with poor network access. For example, according to the January 2003 report from the Public Utilities Commission of Texas ("Texas PUC") reviewing the effectiveness of the performance measures enacted in Texas, SBC has met the performance benchmarks set by the Texas PUC in only 6 out of 31 months for which data are now available.[51] As of July 2002, SBC had paid over $25 million in fines, an amount that would have been higher but for the fact that the Texas performance measure penalties cap payments in certain months.[52] Verizon too has been found to "provide[] special wholesale services in a discriminatory manner" by the New York Public Service Commission.[53] A recent report made to the New Jersey Board of Public Utilities by its auditors found over 100 instances in which Verizon was in violation of the Board's performance reporting guidelines and, as a result, there could be no assurance that Verizon was properly calculating its "incentive payments" or correctly crediting competitive carriers' bills.[54]

And with regard to essential "special access" performance standards at the federal level, there are none. The Commission has yet to act despite having requested comments almost two years ago as to the type of measures and penalties it should adopt.

Verizon also cites the obligation of the BOCs under section 272(b)(5) to enter into arms' length agreements reduced to writing and made available for public inspection. But the section 272 biennial audits highlighted the inadequacies of the public inspection safeguard. For example, the Verizon biennial audit found that nearly 40 percent of the Internet postings of contract summaries were insufficient, and nearly 20 percent of the non-compliant summaries had

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[51] *Scope of Competition in Telecommunications Markets of Texas*, Report to the 75th Texas Legislature, at 50 (Tex. PUC, Jan. 2003).

[52] *Id.* at 52.

[53] Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting, Opinion No. 01-1, Case OO-C-2051, *et al.*, at 6 (N.Y. PSC, June 15, 2001). This discrimination has not ceased. AT&T has recently discovered that Verizon was over-riding its OSS in order to provide its own retail customers far better installation dates than competitive carriers could obtain for their customers. *See generally* Letter from Harry M. Davidow, AT&T, to Dennis Taratus, New York State Dep't of Pub. Serv., *Discriminatory and Lengthy Provisioning Interval Disparity for UNE-Platform* (June 3, 2003).

[54] *See generally* Draft Report on the Review of Monthly Performance Reports and the Associated Incentive Plan Payment Reports Filed by Verizon New Jersey, Presented to New Jersey Board of Public Utilities by Liberty Consulting Group (June 7, 2003).

multiple errors.[55] In addition, there were numerous discrepancies between the affiliate's web postings and the written agreements, concerning such material terms as rates, descriptions of services, and indemnification of parties or personnel and their compensation.[56] Many service agreements were posted on the web with pricing and other material information listed as "to be determined."[57] There also were discrepancies between the posted transactions and those available for public inspection.

Further, the imputation requirement under section 272(e)(3), although an important safeguard, is clearly not a substitute for "structural" safeguards like the ban on OI&M sharing. At best, the imputation rule would protect competitors only from *price* discrimination, not discriminatory provisioning of access facilities. Moreover, because the Commission has yet to promulgate rules that fully implement section 272(e)(3), the Bells have been able to evade this provision by failing to impute costs to the separate affiliate that should be imputed.[58]

Finally, "price cap" regulation (at either the state or federal level) does not eliminate the risk of cost-misallocation. Even with price cap regulation, a BOC has incentives to shift costs from competitive services to regulated services in a manner that harms ratepayers, because price cap regimes almost universally provide a mechanism for re-adjustment of rates where rates depart significantly from costs. For example, as the expiration of the CALLS plan approaches, the BOCs have powerful incentives to shift costs in order to support higher exchange access price cap going forward. And even if there were "pure" price cap regulation with no sharing, earnings cap, or other re-adjustments, the BOCs will nonetheless obtain significant benefits by misallocating costs. For example, by manipulating the affiliate's costs to artificially low levels, the BOC can effect price squeezes on its rivals even as it appears to comply with imputation requirements. And by improperly inflating the costs of its local operations, a BOC can substantially boost prices for essential services like access and network elements that it provides to downstream rivals. In fact, as AT&T has demonstrated, price caps can *increase* the incentives

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[55] The Auditor in Objectives V & VI reviewed 839 web postings of contract summaries; 304, or approximately 37%, were non-compliant. Forty-four of these 304 non-compliant web postings had multiple errors. *See* Auditor's Initial Biennial Report, Appendix A, Objectives V & VI, Procedure 6.

[56] *See* Auditor's Initial Biennial Report, Appendix A, Attachment I, Table 2.

[57] *Id.*, Table 6.

[58] Reply Declaration of Lee Selwyn ¶¶ 21-24 (attached to Reply Comments of AT&T Corp., WC Docket No. 02-112, Aug. 26, 2002); *see also* Declaration of Lee Selwyn, ¶¶ 79-93 (attached to Comments of AT&T Corp., WC Docket No. 02-112, CC Docket No. 00-175, June 30, 2003).

for cost misallocation.[59] Under a price cap regime, a BOC has freedom to shift profits from one affiliate "pocket" to another without ever being forced to pass through "excess" profits to regulated customers. Thus, for example, Verizon could overcharge its section 272 affiliate for services it also provides to competing long distance carriers (and thereby set an unfairly high rate for competitors under section 272(e)), while separately undercharging the affiliate for services it does not provide to competitors, all without a concern about how such pricing would impact the rates it charged regulated customers.

Additional Non-Structural Safeguards. The OI&M safeguards, like structural separation generally, serve both to decrease the ability of a BOC to discriminate against rivals, and as a mechanism for the detection of such discrimination. As the Commission and other regulators have repeatedly held, no conduct or other safeguards could fully substitute for structural separation.

Regardless of the outcome of this proceeding, however, the Commission should take several important steps to strengthen conduct regulation of the BOCs. First, with regard to the detection and prevention of non-price discrimination, the Commission should adopt and enforce rigorous performance measures for special access services. Properly constructed performance measures would help identify attempts by the BOCs to use the absence of OI&M restrictions to discriminate in the provisioning of access. However, as discussed above, the BOCs have treated the penalties imposed by existing "UNE" performance measures adopted by state commissions as a mere cost of doing business. Accordingly, the Commission would need to impose automatic and substantial penalties for discriminatory performance. For these reasons the Commission should adopt the Joint Competitive Industry Group Proposal under consideration in the Performance Measurements and Standards for Interstate Special Access Services Proceeding, which is the result of an industry consensus among the entire spectrum of special access users regarding the performance measures, measurement calculations, business rules, exceptions, disaggregation levels and performance standards that are necessary to measure BOC performance in key areas.[60] Relatedly, the Commission should also adopt AT&T's proposals for reforming biennial audits to ensure that the BOCs are, in fact, complying with existing safeguards.

It is also necessary to prevent BOC abuse of customer preferred carrier choices, changes and freezes. Neutral administration of these customer choices would largely eliminate the regulatory burden in resolving preferred carrier disputes (whether between carriers or between

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[59] Reply Declaration of Lee Selwyn ¶¶ 35-36 (attached to Reply Comments of AT&T Corp., WC Docket No. 02-112, Aug. 26, 2002); *Ex Parte* Declaration of Lee Selwyn ¶¶ 43-44 (attached to *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC (filed CC Docket No. 96-149, Nov. 15, 2002)); *see also* Declaration of Lee Selwyn, ¶¶ 97-103 (attached to Comments of AT&T Corp., WC Docket No. 02-112, CC Docket No. 00-175, June 30, 2003).

[60] *Id*. at 23-28.

carriers and customers and for all services, including local, intraLATA, or interLATA), would facilitate regulatory monitoring of carrier behavior with real-time data while reducing the need for monitoring, and would eliminate the need for additional regulation to address slamming, cramming, BOC discrimination, and consumer frustrations related to preferred carrier freezes. Indeed, this Commission itself has taken a step toward this solution, endorsing, in its preferred carrier freeze regulations, the use of an "independent third party" to confirm requests for preferred carrier freezes.[61] The Commission accordingly should create a mechanism to ensure that the BOCs no longer dominate customers' preferred carrier choices, changes and freezes.[62]

With regard to price discrimination, the only effective check on the BOCs' ability to price squeeze rivals is to remove the BOCs' ability to set above-cost access rates. As AT&T has explained elsewhere, there is a particularly urgent need for such action in the context of special access prices.[63] Since being granted "pricing flexibility," Verizon, BellSouth and Qwest have raised DS-level rates in *every* single one of their Phase II MSAs. These rate increases are far too large and one-sided to chalk up to "rate rebalancing" – the Bells have increased DS-level channel termination rates as much as *70%*. And, as IXC, CLEC, wireless, and broadband special access customers have all documented, the Bells refuse even to engage in serious negotiations over their special access rates.

The Bells' grossly excessive special access rates have extraordinarily far-reaching anticompetitive consequences. Special access is a critical input to *all* suppliers of wireless, broadband, and long distance services (and, because of the use and commingling restrictions, suppliers of local services as well). The Bells' inflated special access rates therefore not only increase the rates that end users must pay for all of these services, but give the Bells' wireless, broadband, and long distance affiliates an artificial competitive advantage. Swift action to constrain special access rates to just and reasonable levels will, accordingly, bring direct and very substantial benefits to consumers and competition in all communications markets.

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[61] 47 C.F.R. § 64.1190(d)(2)(iii); *see also* 47 U.S.C. § 251(e)(1) (mandating a similar approach for administering telecommunications numbering).

[62] Comments of AT&T Corp., at 29-39 (CC Docket No. 02-39, May 10, 2002).

[63] *See generally* AT&T Petition for Rulemaking (RM No. 10593, Oct. 15, 2002); AT&T Reply Comments (RM No. 10593, Jan. 23, 2003).

Sincerely,

/s/ C. Frederick Beckner

C. Frederick Beckner III

Enclosure

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